**IN THE UNITED STATES DISTRICT COURT**

**FOR THE DISTRICT OF DELAWARE**

| | | |
|---|---|---|
| FINJAN SOFTWARE, LTD., an Israel corporation,<br><br>Plaintiff,<br><br>v.<br><br>SECURE COMPUTING CORPORATION, a Delaware corporation, CYBERGUARD, CORPORATION, a Delaware corporation, WEBWASHER AG, a German corporation and DOES 1 THROUGH 100,<br><br>Defendants. | )<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>) | Civil Action No. 06-369 GMS<br><br><br><br><br>**PUBLIC VERSION** |

**DECLARATION OF HANNAH LEE IN SUPPORT OF PLAINTIFF FINJAN SOFTWARE, LTD.'S REPLY IN SUPPORT OF <u>MOTION TO AMEND JUDGMENT AND FOR AN ACCOUNTING OF SALES</u>**

OF COUNSEL:

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Attorneys for Plaintiff
Finjan Software, Ltd.

Dated: May 16, 2008
Public Version: May 23, 2008

I, HANNAH LEE, declare:

1. I am an attorney with the law firm King & Spalding LLP, counsel of record for Plaintiff Finjan Software, Ltd. ("Finjan"). I have personal knowledge of the facts set forth in this declaration and can testify competently to those facts.

2. Attached hereto as Exhibit 1 is a true and correct copy of the Order to Amend the Judgment, filed in IMX, Inc. v. Lendingtree, L.L.C., Case No. 03-1067-SLR, in the United States District Court for the District of Delaware.

3. Attached hereto as Exhibit 2 is a true and correct copy of the Conference Call Transcript of the SCUR - Q1 2008 Secure Computing Corporation Earnings Conference Call on May 1, 2008.

4. Attached hereto as Exhibit 3 is a true and correct copy of Finjan Software, Inc.'s Consolidated Financial Statements as of December 31, 2005, bearing bates numbers FIN009696-717, trial exhibit JTX-15.

5. Attached hereto as Exhibit 4 is a true and correct copy of Finjan Software, Inc.'s Consolidated Financial Statements as of December 31, 2004, bearing bates numbers FIN009718-38, trial exhibit JTX-29.

6. Attached hereto as Exhibit 5 is a true and correct copy of Finjan Software, Inc.'s Consolidated Financial Statements as of December 31, 2006, trial exhibit JTX-28.

7. Attached hereto as Exhibit 6 is a true and correct copy of the Response Expert Report of Carl G. Degen dated December 12, 2007.

I declare under penalty of perjury under the laws of the State of California and the United States of America that each of the above statements is true and correct.

Executed in Redwood City, California on May 16, 2008.

By: ______________________
Hannah Lee

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF DELAWARE**

**CERTIFICATE OF SERVICE**

I, Philip A. Rovner, hereby certify that on May 23, 2008, the within document was filed with the Clerk of the Court using CM/ECF which will send notification of such filing(s) to the following; that the document was served on the following counsel as indicated; and that the document is available for viewing and downloading from CM/ECF.

**BY HAND DELIVERY AND E-MAIL**

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I hereby certify that on May 23, 2008 I have sent by E-mail the foregoing document to the following non-registered participants:

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# Exhibit 1

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

| | | |
|---|---|---|
| IMX, INC., | ) | |
| Plaintiff, | ) | C.A. No. 03-1067-SLR |
| v. | ) | |
| LENDINGTREE, LLC, | ) | |
| Defendant. | ) | |

**ORDER TO AMEND THE JUDGMENT**

WHEREAS, on January 23, 2006, the jury awarded plaintiff IMX, Inc. ("IMX") patent-infringement damages of $5,794,400 against defendant LendingTree, LLC ("LendingTree") with respect to United States Patent No. 5,995,947;

WHEREAS, the jury's January 23, 2006 damages award was based on the number of qualification forms transmitted through the LendingTree Exchange through November 30, 2005 and on a royalty rate of $1.25 per qualification form;

WHEREAS, on January 10, 2007, the Court, based upon the jury's finding of willful patent infringement and pursuant to 35 U.S.C. § 284, increased the jury's damages award by 50% from $5,794,400 to $8,691,600;

WHEREAS, on January 10, 2007, the Court ordered LendingTree to pay prejudgment interest, pursuant to 35 U.S.C. § 284, on the jury's award of $5,794,400, compounded quarterly and at the prime rate;

WHEREAS, on January 10, 2007, the Court ordered LendingTree to pay post-judgment interest, pursuant to 28 U.S.C. § 1961(a), on the jury's award of $5,794,400, calculated from the date of entry of judgment, which occurred on January 10, 2007, at a rate equal to the weekly

average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System for the calendar week preceding;

WHEREAS, on April 25, 2007, the Court ordered LendingTree to produce an accounting of the number of qualification forms transmitted through the LendingTree Exchange between November 30, 2005 and September 14, 2006;

WHEREAS, on May 14, 2007, LendingTree submitted a declaration stating that LendingTree had transmitted 2,113,847 qualification forms through the LendingTree Exchange between November 30, 2005 and September 14, 2006;

WHEREAS, based on LendingTree's transmission of 2,113,847 qualification forms between November 30, 2005 and September 14, 2006, and using a rate of $1.25 per qualification form, the parties agree that, under the formula used by the jury, IMX is entitled to additional damages of $2,642,309;

WHEREAS, on April 25, 2007, the Court ordered that "judgment entered in this case shall be amended accordingly to award damages commensurate with the amended record of defendant's infringing activities";

WHEREAS, LendingTree should be ordered to pay prejudgment interest, pursuant to 35 U.S.C. § 284 on the damages of $5,794,400 awarded by the jury, compounded quarterly and at the prime rate through January 10, 2007, and on the supplemental damages of $2,642,309, compounded quarterly and at the prime rate through June 30, 2007;

WHEREAS, LendingTree should be ordered to pay post-judgment interest, pursuant to 28 U.S.C. § 1961(a), on the total damages of $8,436,709, calculated from July 1, 2007, at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System for the calendar week preceding;

IT IS HEREBY ORDERED as follows:

1. The judgment shall be amended to include supplemental damages of $2,642,309 so that the total damages, consisting of both the supplemental damages and the jury award of $5,794,400, shall be $8,436,709;

2. The damages awarded by the jury shall be enhanced by fifty percent ($2,897,200) to $8,691,600;

3. LendingTree shall pay prejudgment interest, pursuant to 35 U.S.C. § 284, of $1,055,299, consisting of $828,425 for prejudgment interest on the jury award through January 10, 2007 and $226,874 for prejudgment interest on the supplemental damages through June 30, 2007;

4. LendingTree shall pay postjudgment interest, pursuant to 35 U.S.C. § 1961(a), of $152,111 on the damages awarded by the jury, for the period from January 10, 2007 through June 30, 2007;

5. LendingTree shall pay post-judgment interest, pursuant to 28 U.S.C. § 1961(a), on the total damages of $8,436,709, calculated from July 1, 2007, at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System for the calendar week preceding.

IT IS SO ORDERED this 27th day of July 2007

Sue L. Robinson
Honorable Sue L. Robinson
United States District Judge

# Exhibit 2

# Conference Call Transcript

## SCUR - Q1 2008 Secure Computing Corporation Earnings Conference Call

Event Date/Time: May. 01. 2008 / 4:30PM ET

## CORPORATE PARTICIPANTS

**Jane Underwood**
*Secure Computing Corporation - IR*

**Tim Steinkopf**
*Secure Computing Corporation - SVP of Operations & CFO*

**Dan Ryan**
*Secure Computing Corporation - CEO*

## CONFERENCE CALL PARTICIPANTS

**Eric Martinuzzi**
*Craig-Hallum Capital Group - Analyst*

**Rob Owens**
*Pacific Crest Securities - Analyst*

**Jonathan Ruykhaver**
*ThinkEquity Partners - Analyst*

**Fred Ziegel**
*Soleil Securities - Analyst*

**Josh Jabs**
*Roth Capital Partners - Analyst*

**Fred Green**
*Goldman Sachs - Analyst*

**Joe Maxa**
*Dougherty & Company - Analyst*

**Katherine Egbert**
*Jefferies & Company - Analyst*

**Eric Suppiger**
*Signal Hill Group LLC - Analyst*

**Todd Raker**
*Deutsche Bank - Analyst*

**Joel Fishbein**
*Lazard Capital Markets - Analyst*

## PRESENTATION

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**Operator**

Welcome to Secure Computing Corporation's first quarter 2008 results conference call. All participants will be able to listen only until the question and answer session, which will follow today's presentation. (OPERATOR INSTRUCTIONS) Today's call is being recorded. If there are any objections, please disconnect at this time. I will now turn the call over to Miss Jane Underwood, Vice President for Investor Relations.

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**Jane Underwood** *- Secure Computing Corporation - IR*

Good afternoon. And thanks for joining us to discuss our first quarter results. On the call with me today with Dan Ryan, our CEO; and Tim Steinkopf, our Senior Vice President of Operations and CFO.

Before I turn the call to Tim, I'm going to make a cautionary statement regarding forward-looking statements. During the course of this call and the question and answer session following management's remarks, we will make forward-looking statements that involve risks and uncertainties.

Such forward-looking statements are subject to the Safe Harbor created by the Private Securities Litigation Reform Act of 1995. These statements include, for example, statements regarding future results such as guidance for second quarter billings, revenue, gross margin, operating expense, tax expense, interest and other expense, expense reductions, shares outstanding, earnings per share and cash flows and cash balances and statements about our sales pipeline, the breakdown of sales across our product lines and success and availability of our products. Our actual results could differ materially from the forward-looking statements. Factors which could cause actual results to differ include for example risks related to the competition in the securities industry, changes in customer requirements, delays in product development, and the other factors and risks identified in our press release and our SEC filings. We do not undertake any obligation to correct or update any forward-looking statements that may become inaccurate. Now, I would like the turn the call over to Tim.

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Thank you, Jane. Since our final Q1 results are consistent with the preliminary results that we announced on April 7th, we'll briefly review the highlights for the quarter and then spend some time discussing a few cost-saving measures that we undertook this past week. As a reminder, non-GAAP financial measures are reconciled to GAAP in the table at the end of today's press release. Non-GAAP revenue for the first quarter was $65.7 million, an 8% increase over the prior year. Billings for the first quarter were $69.1 million, a 4% increase over a year. Non-GAAP net income for Q1 was $5 million or $0.07 per fully diluted share.

The shortfall relative to our guidance issued on February 4th was largely related to the two issues that we discussed on April 7th. First, our North America commercial business was significantly impacted by a combination of macroeconomic headwinds causing customers to delay purchasing decisions. Second, our U.S. Federal team fell short of their goal due to contracting delays and budgeting issues related to the continuing resolution that the government was operating under at that time. In the last six business days of the quarter, approximately $11 million of revenue from our commit line was pushed out of Q1. Importantly, our EMEA and Asia Pac teams experienced very solid performance, delivering at or close to their target.

In Q1, international billings were 41% of total billings. Domestic billings, excluding the U.S. federal government were 42% of total billing, and the U.S. federal government represented 17% of our total billing. In the first quarter, billings for our gateway security products were 86% of total billing and billings for identity and access products were 14% of total billing. In the quarter, we closed five individual transactions greater than $1 million and an additional 110 deals over $100,000. Deferred revenue increased $6.2 million or 4% sequentially. At end of March, the total deferred revenue balance was $174.4 million. As expected, non-GAAP gross margin was 75% of revenue. Non-GAAP operating income for the quarter was 10% of revenue. In Q1, we generated a $13.1 million in cash from operations. The company's cash and restricted cash balance was $23.7 million on March 31st.

Before I turn to Q2 guidance, I would like to discuss the cost-saving measures we undertook this past week. These measures included the elimination of 75 open positions that we had been planning to fill, the elimination of 75 current positions, additional reductions in non employee-related expenses from plan levels by $500,000 per quarter, and additionally we've reduced our planned capital spending by approximately $5 million for the balance of the year. A few other items to stress. We are maintaining an appropriate headcount in investment and engineering in order to continue fostering innovation, and the steps taken should reduce our forecasted expenses for 2008 by approximately $10 million, which equates to an annual amount of approximately $14 million to $15 million.

Now I would like to turn to our outlook guidance, which is based on current expectations. All of these statements are forward looking and actual results could differ materially. For the second quarter 2008, we expect billings to be up slightly from Q1. Non-GAAP revenue is expected to be in the range of $63 million to $67 million. Non-GAAP gross margin is anticipated to be approximately 73 to 75% of non-GAAP revenue. Non-GAAP operating expenses are expected to be in the range of $42 million to $43 million. Fully diluted weighted average share count is expected to be approximately 75 million shares. Non-GAAP tax expense, which is also approximate, our actual cash outlay for taxes is expected to be approximately $300,000 to $500,000.

Interest and other expense are expected to be approximately $900,000, and Q2 non-GAAP earnings per share is expected to be approximately $0.04 to $0.07 per fully diluted share. We again expect the breakdown of our product lines in Q2 to be approximately 90% for enterprise gateway and approximately 10% for identity and access management. As in prior years, we expect to see a sequential decrease in our Q2 cash generation due to normal seasonality. In Q2, cash generated from operations is expected to be approximately $3 million to $4 million. And consistent with normal seasonality, we would expect Q3 cash generation from operation to increase to approximately $6 million to $8 million. We expect Federal billings for Q2 to account for 15 to 20% of total billings.

And before I turn the call over to Dan, I would like to point out that we're suspending full year '08 and '09 guidance. Given the uncertain macroeconomic guidance and the amount of deal slippage we experienced in Q1, we believe it's prudent to only provide Q1 guidance at this time. I'd like to turn the call over to Dan.

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**Dan Ryan** - ***Secure Computing Corporation - CEO***

Thank you, Tim, and good afternoon. We are disappointed with our Q1 results and are taking aggressive actions to improve our future performance. This includes restructuring described by Tim and the implementation of a growth plan that I will briefly describe now. Over the last several months, the senior management team has been developing a strategy that will allow us to better capitalize on the market opportunities before us and provide stronger top and bottom line growth. Our board of directors has endorsed this plan and we're now aggressively executing on it.

While there's certainly excellent growth opportunities for each of our product lines, I'm a big believer in focus. Our increased focus will take two forms. First, we will commit substantially more of our resources to the areas of our business where we believe we can be the clear market leader. And second, we'll narrow the scope on our remaining products to the market segments where we have proven success and an opportunity for segment leadership. Regarding the former, our simple objective is to become the clear leader in secure web gateway market over the next 18 months and to remain a leader in the e-mail gateway market. The secure web gateway is a lucrative golden opportunity, and we are already in the strong position there. According to Gardner, there's only a 10 to 15% penetration of these solutions in the enterprise and 20 to 25% annual growth is anticipated.

Hosted web security, while smaller today than appliance base, is expected to grow at 36% annually according to IDC. We plan to address the web gateway market with flexible hybrid delivery model and that means appliance based virtualized and hosted or in the cloud offerings. In the coming weeks, we will launch a hosted web security service to complement our already successful appliance based offerings as well as our recently announced virtual offerings.

The new SAS, or software to service offering, leverages our web gateway technology as well as the worldwide data center infrastructure that exists for TrustedSource today. We're excited about both our current situation, as this is our most successful growth area, and the ability to accelerate this area based on an incremental investment combined with the high growth opportunity in the market. We remain a leader in the secure mail gateway market as well, which is another attractive growth area and one that has substantial synergies with web security. Similarly, we plan to offer flexible delivery models to our customers there.

In summary, our long-term strategy for web and mill security is to allow our customers to purchase market-leading security services and deploy them across different platforms to mix and match any configuration. This will deliver service portability, common policy in reporting, and unified pricing across all delivery models. Next, with respect to narrowing our scope on the remaining products, we have an excellent franchise in secure firewall or Sidewinder, the industry's leading application firewall. Our success in government financial services and high assurance networks in regulated and other industries continues to be strong. We protect some of the world's most critical networks and applications. If there's valuable data to be protected, we are a strong solution that should be considered.

Secure's firewall is also unique in that it's a software product that is readily virtualized and we will take advantage of that as well. Also, we offer the only application firewall that's fully integrated with the Reputation system, our TrustedSource system. Our emphasis going forward will be to aggressively attack and lead these key segments of the broader firewall market. Similarly, with SafeWord, we have a great platform to build from with the reformulated users today. Our primary emphasis will continue to be remote access solutions that can be rapidly deployed in Microsoft centric environments.

To summarize, we've reduced our cost structure and we are substantially increasing our investment in the high-growth areas where we believe we have the opportunity for clear leadership. In the other areas, we're narrowing our scope, and we will continue to strengthen our team throughout the organization. To that end, I'm pleased to announce that Steve Kozachok will be joining Secure Computing next week as our new Senior Vice President, Secretary, and General Counsel. Steve comes to us from St. Jude Medical, where he served as Associate General Counselor for the last three years and was the primary lawyer responsible for business development efforts. Before that, Steve was a partner in the law firm of Dorsey & Whitney, where he was Lead Outside Merger and Acquisition Counsel to a Fortune 50 company. I speak for the entire management team in saying we remain highly optimistic about the future of Secure. Operator, we would now like to open the call to analysts' questions.

## QUESTION AND ANSWER

**Operator**

(OPERATOR INSTRUCTIONS) Our first question comes from Joel Fishbein with Lazard. Your line is open.

**Joel Fishbein** - *Lazard Capital Markets - Analyst*

A couple of questions. First can you give us more color on some of the product lines, Webwasher and Ironmail in particular, your secure web or secure mail, how they did in the quarter?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

We don't typically segment them out, but I will say that the -- our web gateway product line is certainly the highest growth area and is growing significantly higher than those market rate growths that we mentioned from Gardner's perspective, but beyond that we don't segment them.

**Joel Fishbein** - *Lazard Capital Markets - Analyst*

How about in terms of the competitive landscape there? Any better, any worse?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I think that we're seeing the same competitors on the web gateway. I think that we feel we have an opening door to walk through or jump through, run through or whatever you say, that some of our competitors are quite busy with either digesting acquisitions or just embarking on them, a couple of our primary competitors. We're hoping that gives us a little bit more of an entry to really take that market. Our intention here is to dominate the web gateway market and that's really what you're going to see focus of this company be for the next year.

**Joel Fishbein** - *Lazard Capital Markets - Analyst*

The second question comes, regarding, Tim, you talked about last quarter. On the last call, about $11 million got pushed from Q1. And even assuming you got half of that in Q1, you would have crushed the number. Why the lower guidance for Q2?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Yes, we've never had that many deals or that amount of deals slip out of the end of a quarter as we discussed on the 7th. And although there are some results out there that did fine for Q1 and said they were fine for North America, there were certainly other data points where there is concerns about the North America economy, market, macroeconomic environment, et cetera. Given that we're looking at a phenomenon at the end of Q1 that we've never seen before and the overall macro environment in the Americas especially, we felt it to be prudent to be conservative as look into Q2.

**Joel Fishbein** - *Lazard Capital Markets - Analyst*

All right. I'll jump back into queue. Thanks.

**Operator**

Eric Martinuzzi, your line is open with Craig Hallum.

**Eric Martinuzzi** - *Craig-Hallum Capital Group - Analyst*

Curious, given the guidance on the billings for Q2, I think up slightly from Q1 is the way you characterized it. That would imply a decline from a year ago. A year ago we had -- I think billings were $70.7 million or so. So up slightly. Is that $69.5 million or is that $71 million? Could we be in a contracting mode here for the foreseeable future?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I think we would say that we expect to be may be up slightly from prior year as well. But, again, when you look at the macro environment, we feel it prudent to look hard at the pipeline we have and feel comfortable with what's in that pipeline relative to expectations to close and guide appropriately. And that still means that there's basically two months to go on this quarter. There's a lot of work to get done.

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**Eric Martinuzzi** - *Craig-Hallum Capital Group - Analyst*

One more if I might. One of the things you've done is looked at your cost structure. What about your business segments? Is that on the table? Could we see potential strategic diversification here where maybe we aren't in certain businesses in the future that we currently are in?

---

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I don't think we have any particular plans to announce there, but I would say in looking at our strategy, anything's on the table. We'll do anything that we think maximizes the shareholder value and our growth opportunity and whether that's acquisitions or doing what you suggested.

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**Eric Martinuzzi** - *Craig-Hallum Capital Group - Analyst*

Thank you.

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**Operator**

Rob Owens with Pacific Crest Securities, your line is open.

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**Rob Owens** - *Pacific Crest Securities - Analyst*

Yes, good afternoon, everyone.

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**Dan Ryan** - *Secure Computing Corporation - CEO*

Hi, Rob.

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**Rob Owens** - *Pacific Crest Securities - Analyst*

Any type of update you can give us with regard to the lawsuit with Finjan, where you're at in that process?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Where the status is -- the jury has entered a verdict against us. We won on one count on the trial. They won on two counts. There was a verdict entered against us, and we have filed motions relative to that, we were asking the judge to set that aside, reduce the damages, et cetera, et cetera. Of course, Finjan has also filed motion for an injunction. All of the typical motions that both sides would file. We expect the judge to rule on those motions in three to five months, so sometime maybe in Q2. It might slip into July/August. Can't readily predict that. I'm sure whoever comes out on the short end of the judge's ruling will file appeals to the appellate court and that will take one year to two years to play out. A lot of game to be played there yet. As we've stated before, we don't believe that's going to be a material item to the company when it eventually does get resolved. But it's probably at least 1.5 years plus time rame before it's finally all put to rest.

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**Rob Owens** - *Pacific Crest Securities - Analyst*

Along those lines, is that causing any disruption in the selling process? Customer adoption team, I guess?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

It's certainly been distracting to us as a company. I think obviously Finjan is putting this out in the market in front of a lot of prospective customers and trying to make something of that. I would say that -- I am aware of one substantial deal that we would directly relate to this. We're not aware of any other ones at this time. They may exist, but we're not aware of them, and there was one specific one we know. We should also -- I'm sure you've heard this before this infringement isn't about the broader Webwasher product line. It's about one element of that product line and we do have the ability to ship the product today without the alleged infringement if we chose to do that. We are obviously not choosing to do that, and we have a long ways to go in the fight. So I think -- another thing is we don't really see Finjan competing with us in many deals. The [Fillmore], the Bluecoats and WebCensus we're seeing on the Webwasher side. But I would say it hasn't been a terrible business environment for us because of it. It has been some distraction to it and there is some small business impact.

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

It's kind of a nuisance on the side. It's there. We have to deal with it. We don't see them that much, but it is a bit nuisance. You couldn't say it's had zero impact. It's been a nuisance.

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**Rob Owens** - *Pacific Crest Securities - Analyst*

Great, thanks.

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**Operator**

Jonathan Ruykhaver with ThinkEquity, your line is open.

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**Jonathan Ruykhaver** - *ThinkEquity Partners - Analyst*

Good afternoon. It looks like you incurred $2 million in legal expenses related to Finjan. Is that the type of run rate we should expect in terms of cash expense in the next few quarters?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

No. So, yes, you're correct we did incur a fairly significant item in Q1 because of the trial, et cetera. But going forward, probably $300,000 to $400,000 a quarter for a couple quarters or two or three quarters has been built in. That's what we would expect to incur for the balance of the year.

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**Jonathan Ruykhaver** - *ThinkEquity Partners - Analyst*

That's not included in the non-GAAP guidance you gave?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

It is included.

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**Jonathan Ruykhaver** - *ThinkEquity Partners - Analyst*

It is. Okay.

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**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

It is included.

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**Jonathan Ruykhaver** - ***ThinkEquity Partners - Analyst***

In terms of the $11 million deals that slipped out of March, would you characterize most of those as network security products?

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**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

We looked at that and yes, probably more gateway security then I am, but in some respects fairly evenly spread out across all four product lines.

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**Jonathan Ruykhaver** - ***ThinkEquity Partners - Analyst***

So you even saw some pushed out of the web security side?

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**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

Yes, and it wasn't necessary to any product line. It seemed to be more focused by geography because we didn't see the slippage in EMEA in any type of product line nor in Asia Pac, but we saw it in North America and a little bit in Iap and North America especially, and it seemed to be across all product lines. But at the end of the day, as Dan stated in either one of his questions or prepared remarks, was we still are seeing as far as all of the product lines go, an IDC would probably back this up as well. Our best growth opportunity, and we're seeing it in our activity, is in the web gateway area.

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**Jonathan Ruykhaver** - ***ThinkEquity Partners - Analyst***

Right. And I guess just going back to the network gateway marketplace. Is there a contraction that's occurring in that marketplace or is there heightened competition? I'm trying to get a sense of what is causing the problems in that particular market, because I think most of your gateway business is probably in the firewall marketplace.

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**Dan Ryan** - ***Secure Computing Corporation - CEO***

I don't think -- we have three gateway products: mail, web and firewall. I would say, as Tim said, there's some contraction in each. I don't think we're seeing any particular fallback in our network gateway business. We actually had a nice growth in that business over the past year. I think that the -- it doesn't have the kind of growth we're seeing in web gateway, but I don't think we've seen a particular fallback. We focus in on we have a very good position, I don't know if you call it a niche market or a sub segment of these high assurance network and we do a lot in government and financial services. And there's a lot of initiatives that are supporting whatever downturn there is economically when you have [PCI DFF] initiatives and this critical infrastructure initiatives are going on right now. We're in a lot of those deals. I wouldn't say that there was a pretty good fallout in our network gateway any more than any other --

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**Jonathan Ruykhaver** - ***ThinkEquity Partners - Analyst***

Year-over-year looking at the billings growth being flat year-over-year for the most part and you're saying the web gateway business is growing and mail is probably doing okay. It would have to be either the authentication or the firewall business that's been showing accelerated growth.

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**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

Maybe another way to think about it is when the markets -- we perceive the markets to still be strong, it's just that they seem to be a little bit pressured right now. But we don't perceive it to be in the market. We perceive it more in the macroeconomic environment. Products are not going away -- they're getting pushed out. People are not saying they're not important or they're not going to do it. They're saying I need to get another signature or need to go back through CapEx committee or it's going to take us longer to get approved. What we're seeing is more of a macro pressure from the environment than a specific segment of the market that's kind of backing up.

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**Jonathan Ruykhaver** - *ThinkEquity Partners - Analyst*

Okay. So is it safe to assume that based the revenue guidance for June, you're being pretty conservative still as it relates to closure rates, sales cycles, continue to deteriorate?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

That would be the way to think about it.

---

**Jonathan Ruykhaver** - *ThinkEquity Partners - Analyst*

All right, guys. Thanks.

---

**Operator**

Fred Ziegel with Soleil Securities, your line is open.

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

Hey, Fred.

---

**Fred Ziegel** - *Soleil Securities - Analyst*

Let me ask a couple of things. First, on the bigger deals, I would presume they are generally multi-product in terms of people looking at doing a couple of different things?

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

Probably more often they're not, actually, Fred. I would say many of the big deals tend to be single product, kind of enterprise rollout or enterprise deployment. We do have multi-product deals all the time, but I wouldn't characterize -- if you went through our biggest deals, they're more likely to be one product than they are to be three.

---

**Fred Ziegel** - *Soleil Securities - Analyst*

Okay.

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I agree and what that actually provides us is the opportunity to cross sell which we're definitely seeing an uptick in.

---

**Fred Ziegel** - *Soleil Securities - Analyst*

But if we're going to defocus some areas of the business, does that opportunity go away?

---

**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

No, because I think what maybe -- paraphrase Dan's comments, it is focus in on the areas where each product is the strongest. So web and mail happen to be strong in broad areas and we can look to be market leaders there in broad areas. Whereas secure firewall, secure IM, they are potentially a little bit more focused or have the opportunity to be leaders in a little bit more focused area. And that's where we will have the most success cross selling also. It's focusing in where we're the strongest.

---

**Dan Ryan** - ***Secure Computing Corporation - CEO***

If we have an account that's a big Webwasher account and they're looking for firewalls, we're not going to tell the salesperson not to introduce Sidewinder to the account because it's not in one of the key verticals. In reality, we'll have more cross selling in the two or three verticals for firewall than we would in the general world.

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**Fred Ziegel** - ***Soleil Securities - Analyst***

The 75 person headcount reduction -- how is that spread out across the various disciplines?

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**Tim Steinkopf** - ***Secure Computing Corporation - SVP of Operations & CFO***

We tried very hard to impact sales generation the least amount as possible, and we tried also to impact our development team probably second least amount possible. So what I'll call the service organizations within the company, legal, HR, marketing -- we tried also to limit the impact to marketing. That probably was third in line. But then the service organizations, the balance of marketing, legal, HR, finance, operations, IT, et cetera -- those groups really stepped up and said we're going to try to cut our costs as aggressively as possible because we want to maintain our investment in innovation and the road maps we're on and want to maintain the lead generation pipeline generation machine.

---

**Dan Ryan** - ***Secure Computing Corporation - CEO***

Hopefully it's clear also from the discussion that we not only took that money out of the company that Tim described. We added specifically a substantial amount of money back to the web gateway development and go to market areas. So that's all built into the numbers that we gave you. So the actual cut was probably more substantial when you consider that addback.

---

**Fred Ziegel** - ***Soleil Securities - Analyst***

Okay. All right, thanks.

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**Operator**

Josh Jabs with Roth Capital, your line is open.

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**Josh Jabs** - ***Roth Capital Partners - Analyst***

Good afternoon.

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**Dan Ryan** - ***Secure Computing Corporation - CEO***

Hey, Josh.

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**Josh Jabs** - *Roth Capital Partners - Analyst*

On the previous call, you talked about the government sector, the Federal sector, and some of the issues that you had seen in Q1. How is that looking for Q2 and Q3?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

I would say we're cautiously optimistic about the U.S. federal government plan right now. Obviously we're fool me once or fool me once, right? But we're being cautious and I think we're seeing a strong opportunity there, a good comeback.

---

**Josh Jabs** - *Roth Capital Partners - Analyst*

And then, going back to this product diversification or consolidation or however this plays out. You mentioned the area of focus. At the same time, it seems like the market has been looking for more consolidated offerings. Specifically, how do you pull back in one area such as UTM, but continue to invest the others and does that mean more of a downmarket shift with the service's offerings?

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

I think when you talk about the combination, the natural synergy is between web and mail. There's a much more natural synergy in selling those products together. And that is a consolidated offering. If you look at what we're doing, we're trying to come up with a set of services, web and mail-based services, that we don't care which ones you pick and how you want it delivered, whether it's in a box in the cloud. That is very synergistic, more so than with the firewall, with the firewall business I think. I would we're not trying to necessarily narrow our product breadth. However, we do want to be known for something and secure computing in the broader sense really hasn't been known for something. And our objective here is we want to take leadership in a market. That'll accelerate our channel and accelerate our customer acquisition. And then we can bring all of our other products into it as well.

---

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I would submit to you, Josh, I think we're potentially a step or two or three ahead of our competitors in consolidation. We already consolidate at the web gateway services such as FSL, SML or anti-virus, web filtering, et cetera. We have the same type of consolidated services at the mail gateway with DLP encryption, AV, TrustedSource reputation. We have trusted reputation-based technology at the web as well. And look at our set of services at the enterprise gateway. I think Secure has actually been a leader in consolidating services at appropriate areas or appropriate spots in the network. Now what we're saying is we're going to take those spots and really focus in on trying to capitalize on our leadership there.

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

One more example -- Tim brought up some good ones -- that the mail and web gateway, there's a lot of discussions in the market today about daily prevention or protection DLP. A lot of companies that we partner with on a regular basis in our web gateway solution. With these services, we have between web and mail, the vast majority of the deal [promised] in motion between those protocols, web and mail. One of the thing we want to do is provide DLP services with policy across them. We're going to continue consolidate, for in motion date. We're not trying to replace Vontu anybody on desktop-type applications, but the 80/20 rule is if you can stop the majority of it there, that's another great service we can consolidate.

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**Josh Jabs** - *Roth Capital Partners - Analyst*

Moving to the service -- on the services side. Will that put you into competition with any of your service provider customers?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

Not that we're aware of. We have some MSP partners that provide services. In fact, we would see an opportunity to actually license our services through other partners that could actually sell those services. We have no issue private labeling some of these hosted security services, if that makes sense.

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**Josh Jabs** - *Roth Capital Partners - Analyst*

And then specifically on the OEM side with some of your services. I know you've expanded that quite a bit here this spring, but can you just give us some color on how that's going?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

Could you repeat that?

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**Josh Jabs** - *Roth Capital Partners - Analyst*

The OEM with the partnerships specifically for TrustedSource?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

We continue to go down that path. I think we have several partnerships. I would say our most active partnerships are less around TrustedSource and more around virtualization and also working with Riverbed in some joint solutions. I think that the TrustedSource alliance we have had out there -- we continue to market that and to sell that and we're active there. I don't think that's a big revenue opportunity for us in the near term.

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**Josh Jabs** - *Roth Capital Partners - Analyst*

Okay.

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I think in a broad sense, we believe that -- and I think that quite a bit of the market or IT pundits would agree that eventually reputation-based technology is going to be a clear driver or gating factor for activity on the web, and TrustedSource is a leader there. It's best for us to continue the broad capture of data such that we can maintain TrustedSource as the true leader in that reputation based arena.

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

That's another good point where we see synergy and consolidation between web and mail. We have TrustedSource reputation information now includes web reputation, malware, again mail reputation as we always have. And as we get into the cloud and all of a sudden have thousands more points of reference and data collection, because of our customers are going through the service. We just get that much more visibility on the data that's out there that we can correlate.

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**Josh Jabs** - *Roth Capital Partners - Analyst*

Last question. A little bit of the shift in focus here, and the cost reductions cause a change in the comp structure that you recently introduced for your sales team?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

No, it will not. The comp structure with the emphasis on new business development and cross selling remains intact.

**Josh Jabs** - *Roth Capital Partners - Analyst*

Okay. Great, thanks.

**Dan Ryan** - *Secure Computing Corporation - CEO*

It's definitely having an impact.

**Operator**

Sarah Friar with Goldman Sachs, your line is open.

**Fred Green** - *Goldman Sachs - Analyst*

Hey, this is Fred [Green] for Sarah. You're taking a pause in paying down your debt right now. How long do you expect before you resume paying it down and is there a certain amount of cash you're looking to keep on your books going forward?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Yes, we have taken a pause, Fred, and the big reason we took a pause is because of the macroeconomic environment. And again, we just saw this macro environment and said maybe it would be better to put that cash on the balance sheet. I think -- although we have not determined an exact level of what we want on a balance sheet before we start paying again, I think somewhere between $25 million and $50 million. And that will be a discussion we have with the board on an ongoing basis. And then I think once we build it up to a certain level, we'll consider paying down more or maybe we'll build it up to a certain point where we can pay down some big chunks at certain time levels. For the near future, we're going to be putting the money on the balance sheet for now.

**Fred Green** - *Goldman Sachs - Analyst*

Okay. Great, and do you have an update on sort of how long you think it will be until you have a workaround for the Finjan patents?

**Dan Ryan** - *Secure Computing Corporation - CEO*

I don't know that -- I'm not going to talk about a workaround. We have the ability immediately to ship a product without the piece of the product that is alleged to infringe. We don't agree it infringes, but if we were caused to, we could ship a product without that. It's one type of detection mechanism among many on the product, and we can ship without that.

**Fred Green** - *Goldman Sachs - Analyst*

Thanks a lot.

**Operator**

Joe Maxa with Dougherty and Company, your line is open.

**Joe Maxa** - *Dougherty & Company - Analyst*

Regarding your SafeWord and your narrowing your focus to the remote access solutions, does this mean you're effectively taking yourselves out of the larger consumer authentication opportunities?

**Dan Ryan** - *Secure Computing Corporation - CEO*

I think when we say focused, we have some of the largest deployments in the world too. So it's a little bit of a dichotomy. But with SafeWord 2008 and really the successful no touch channel we've built around SafeWord and Microsoft deployments, we're going to continue to put a lot of the focus there. That's what is growing well for us. That's what has the best channel progress right now and that's the one that we think we have some uniqueness. Our product rolls out in that environment very easily, much more readily than most products, and this is where the marketing focus would be, I'd say. I guess we'll still continue to sell into accounts we're in. This is where we see a nice, steady predictable growth through a relatively low-touch channel.

**Joe Maxa** - *Dougherty & Company - Analyst*

Are you see any changes in the market that will keep you from more aggressively going after the hardware token side?

**Dan Ryan** - *Secure Computing Corporation - CEO*

We do the mobile [pass-type] electronic token which of course everybody's anticipated would be replacing tokens and that has not come to fruition. We still have a vast majority of the business goes with physical tokens, and we haven't seen a substantial change in our business, at least right now. We keep anticipating we'll move to other forums. We're very aware of that, but it hasn't happened yet.

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

What Dan just said is may be the key item to both questions you asked, Joe, and as much as we continue to look for consumer opportunities, or et cetera, the token market is not evolving that quickly. It seems like remote access tokens is still the leading solution and the market has not really embraced the next step or the next direction. So, what we want to do currently is try and capitalize on that and make the most of that. In the meantime, we will certainly be paying attention to where does that next path really show up. So that we can then jump into that. At present, tokens, remote access, business enterprise, is still the leading drivers in that part of the market.

**Joe Maxa** - *Dougherty & Company - Analyst*

Great, thanks a lot, guys.

**Operator**

Katherine Egbert with Jefferies, your line is open.

**Katherine Egbert** - *Jefferies & Company - Analyst*

Hi, I think before you answered the question about what positions you cut and you said it was mainly services. What planned positions did you eliminate?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

I'm sorry, Katherine, you must be on a mobile. You're cracking up. We did eliminate services and you said what?

**Katherine Egbert** - *Jefferies & Company - Analyst*

What planned positions?

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Oh, planned positions. Planned positions was a little bit more across the board. We're not seeing quite the level of growth that we have been planning on, and the plan, of course, had been kind of not -- it's not a perfect peanut butter spread across the whole organization, but it was spread across the whole organization. So the planned position was a little bit more evenly spread across the board.

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**Katherine Egbert** *- Jefferies & Company - Analyst*

Thanks.

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**Operator**

Eric Suppiger with Signal Hill, your line is open.

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**Eric Suppiger** *- Signal Hill Group LLC - Analyst*

Good afternoon.

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**Tim Steinkopf** *- Secure Computing Corporation - SVP of Operations & CFO*

Hey, Eric.

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**Eric Suppiger** *- Signal Hill Group LLC - Analyst*

Did you give the headcount earlier?

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**Tim Steinkopf** *- Secure Computing Corporation - SVP of Operations & CFO*

No, but I think post the actions we've took this week, we should be right around 900.

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**Eric Suppiger** *- Signal Hill Group LLC - Analyst*

And I presume at the end of the quarter it was 975? So all of the cuts have been done at this point?

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**Tim Steinkopf** *- Secure Computing Corporation - SVP of Operations & CFO*

Yes, substantially, yes.

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**Eric Suppiger** *- Signal Hill Group LLC - Analyst*

Okay, can you give us a little feel -- I guess I'm trying to understand what parts of the firewall market you're going to be redirecting your focus away from?

---

**Dan Ryan** *- Secure Computing Corporation - CEO*

Well, I think I would say we don't feel that we are probably a strong competitor in the general network firewall space horizontally, right. That's not our strength. We are much more specialized in high-value data, high-value applications. And in many cases our firewalls are used behind other perimeter firewalls. So I think what we're saying is that our development effort is going to be to double down where we win today. And we do a fantastic job in federal government, in financial services, and utilities in other areas where we're protecting high value applications and data,

and I think it's easy for us to find ourselves competing with network firewalls. It's easy to get drawn into those fights against the big firewall players.

And I think we want to pick the fights where we can win and really go aggressively after those instead. We don't want to find ourselves in every network deal. We want to be in the deals where they're high value and high margin and we have a layer 7 orientation, an application layer orientation where we have a 3 out of 4 chance of winning, not a 3 out of 4 chance of losing.

---

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

To add on briefly, we're going to compete with the same people, if it's a layer 3 or 4 deal. If it's a perimeter network deal, as we compete with when it's a layer 7 deal. When it's in front of an Oracle server or application et cetera. We're certainly going to compete. But we have a much better chance to win when it's a layer 7 oriented-type of project and that's where we really want to make sure. You get into those high assurance networks. That's where we're going to get a higher win ratio. So we're going to make sure we're really focusing in and competing in as many of those as possible.

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

The other thing we mentioned briefly that we're just embarking on, we announced this week some activities we're doing in virtualization. Our product is a software product, effectively running on a hardened black box, but this is very easily virtualized. We don't have a lot of semiconductor dependencies. So we have some unique capability where people need virtual firewall capabilities that many of the other competitors do not have, and depend on silicon and proprietary platforms.

---

**Eric Suppiger** - *Signal Hill Group LLC - Analyst*

Okay, and then can you help us a little bit in terms of measuring how your stronger-performing products are performing? Specifically, I'm talking about the web gateway and the mail security products. You're not breaking them out, so can you give us some way of gauging how your success in those areas is performing since that's arguably where the greatest investor interest would lie?

---

**Dan Ryan** - *Secure Computing Corporation - CEO*

We're not breaking them out now. We may chose to do that, however, in the future so there would be more clarity on that. I would just say what I did mention, is that Gardner has said the market rate is growing for web -- is the least penetrated at 15% with growth rates depending on whether it's appliance or wholesale somewhere between 20 and 36%. And I think that our recent history for Webwasher has been in excess of those growth rates. I would say mail is almost inextricably -- it can't be removed from web. I think it's becoming part of web, particularly related to the web 2.O protection opportunity with our SWAT program. Mail and web are a hybrid solution now, and we're seeing those will emerging more and more together in our eyes with our solutions. We'll probably talk about these together. We probably won't even separate. If we do more segmentation, it probably won't be to separate web from mail. It might be to separate web and mail from network and access.

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**Eric Suppiger** - *Signal Hill Group LLC - Analyst*

As a sales strategy, are you moving away from bundling the firewall with either the web or the mail and just selling them on a bundled basis more often?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

We still sell the firewall as the right solution to put in front of our other gateways. Obviously, we try and put as many of our products in as possible, but I think that -- that's a different procurement in many cases. So there's just more synergy with web and mail and I think from a cloud perspective, having a hosted offering, having the flexibility of having remote offices or home or internet cafe users going through the cloud and people at corporate going through the appliance. We see a more natural synergy between mail and web services.

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**Eric Suppiger** - *Signal Hill Group LLC - Analyst*

Last one, is there much cost associated with the infrastructure for the hosted service?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Yes, there's cost, of course, in rolling it out. And hopefully there's going to be a lot of costs because it will be so successful that we'll need a lot of capital and pipes going in. But we do have, I believe seven data centers around the world today that support our TrustedSource environment, so we're quite familiar with this. It's not like we're a startup diving into this for the first time. So it really is layering on hardware and software infrastructure in those data centers and in some cases increasing the pipestone.

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**Dan Ryan** - *Secure Computing Corporation - CEO*

We have that in our plan. That's in the budget that we described to you.

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**Eric Suppiger** - *Signal Hill Group LLC - Analyst*

Very good. Thank you.

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**Operator**

Thank you, our last question comes from Todd Raker with Deutsche Bank. Your line is open.

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**Todd Raker** - *Deutsche Bank - Analyst*

Hey, guys, two questions for you, can you hear me?

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**Dan Ryan** - *Secure Computing Corporation - CEO*

Yes.

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**Todd Raker** - *Deutsche Bank - Analyst*

First, just looking at the balance sheet, it look like long-term deferred revenue kind of came down as a percentage here. Are you seeing shorter duration bookings and if so what's driving it, the economy?

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**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Actually yes to both. Yes, we did see a reduction in the longer term, and yes, when it was specifically cited as to why that would happen, the economy, budget dollars, cash flow was the most often-cited reason.

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**Todd Raker** - *Deutsche Bank - Analyst*

And if I step back, you guys are clearly cautious with the outlook given the experience you had, but if I look more generally across the security space, the results by and large have been relatively robust. And it doesn't look like some of the larger companies in this space are seeing the same type of macro headwinds that you guys are.

---

**Tim Steinkopf** - *Secure Computing Corporation - SVP of Operations & CFO*

Well, what I would say is that there are certainly a few companies that have had some troubles, along with us. I would agree with you that there's been some that have not. The interesting thing for us is that if our government business had not run into troubles via the budgeting, et cetera, we would have hit our numbers. And therefore, we would have put up potentially exceeds numbers, maybe a little short on billings, but the rest of the numbers, revenue and earnings, et cetera, cash flow, would have all been at the high end, if not maybe even exceeded guidance. And it's interesting, in analyzing that situation, there's some people -- I'm not saying we're predicting this, but in analyzing the situation looking forward, there's at least some level of concern that the Q2 will be when the commercial markets really come home to roost. And I think you've seen that in the more conservative guidance headed into Q2. So some companies have made their Q1 numbers. They've got it conservatively for Q2. We would have been in that same boat if we hadn't had the double whammy of government as well. I think for us we're very much -- we are somewhat concentrating on government. We will also have that concentration in finance and banking, which of course they're suffering from macro factors as well. That would be our view of it.

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**Todd Raker** *- Deutsche Bank - Analyst*

All right, thanks, guys, appreciate it.

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**Operator**

I'll turn the call back over to Dan Ryan.

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**Dan Ryan** *- Secure Computing Corporation - CEO*

Well, thank you for joining us and thanks for taking the time to ask the questions. Hopefully we answered them and look forward to updating you on our progress in three months. We remain optimistic on our business and hopefully we'll have something good to report in three months.

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**Operator**

Thank you. This does conclude today's conference call. You may disconnect at this time.

# Exhibit 3

# FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES.
## CONSOLIDATED FINANCIAL STATEMENTS
## AS OF DECEMBER 31, 2005

Joint Trial Exhibit
**JTX-15**
Case No. 06-369 GMS

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2005

IN U.S. DOLLARS

INDEX



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[redacted]

ERNST & YOUNG

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Fax: 972-3-5622555

## REPORT OF INDEPENDENT AUDITORS

To the Stockholders of

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of Finjan Software, Inc. ("the Company") and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2005 and 2004, and the consolidated results of its operations and cash flows for each of the two years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States.

Kost Forer Gabbay and Kasierer

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
January 23, 2006

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

| | Note | December 31, 2005 | December 31, 2004 |
|---|---|---|---|
| **ASSETS** | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | | $ 8,526 | $ 4,499 |
| Trade receivables (net of allowance for doubtful accounts of $ 0 and $ 10 as of December 31, 2005 and 2004, respectively) | | 2,423 | 3,463 |
| Deferred costs *) | | 937 | 128 |
| Prepaid expenses and other accounts receivable *) | | 383 | 308 |
| Inventory | | 420 | 209 |
| Total current assets | | 12,689 | 8,607 |
| LONG-TERM PREPAID EXPENSES AND DEPOSITS: | | | |
| Deferred costs *) | | 511 | 140 |
| Prepaid expenses and deposits *) | | 75 | 169 |
| Total long-term prepaid expenses and deposits | | 586 | 309 |
| SEVERANCE PAY FUND | | 384 | 374 |
| PROPERTY AND EQUIPMENT, NET | 3 | 486 | 622 |
| Total assets | | $ 14,145 | $ 9,912 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | |
| CURRENT LIABILITIES: | | | |
| Trade payables | | $ 633 | $ 593 |
| Employees and payroll accruals | | 875 | 952 |
| Deferred revenues | | 5,340 | 4,374 |
| Accrued expenses and other liabilities | | 974 | 1,180 |
| Total current liabilities | | 7,822 | 7,099 |
| LONG-TERM LIABILITIES: | | | |
| Long-term deferred revenues | | 3,061 | 2,227 |
| Accrued severance pay | | 535 | 556 |
| Total long-term liabilities | | 3,596 | 2,783 |
| STOCKHOLDERS' EQUITY: | | | |
| Stock capital - | 5 | | |
| Common stock of $ 0.01 par value - Authorized: 27,000,000 shares at December 31, 2005 and 2004; Issued and outstanding: 347,065 and 247,190 shares at December 31, 2005 and 2004, respectively | | 4 | 3 |
| Series A, B, C and D Preferred stock of $ 0.01 par value - Authorized: 19,104,289 and 18,140,278 shares at December 31, 2005 and 2004, respectively; Issued and outstanding: 19,104,289 and 16,854,931 shares at December 31, 2005 and 2004, respectively; Aggregate liquidation preference of $ 34,296 as of December 31, 2005 | | 191 | 168 |
| Additional paid-in capital *) | | 42,331 | 38,904 |
| Treasury stock | | (9) | (9) |
| Accumulated deficit | | (39,790) | (39,036) |
| Total stockholders' equity | | 2,727 | 30 |
| Total liabilities and stockholders' equity | | $ 14,145 | $ 9,912 |

*) Reclassified.

The accompanying notes are an integral part of the consolidated financial statements.

January 23, 2006
Date of approval of the financial statements

Asher Polani
Chief Executive Officer

Kfir Kraitsman
Director of Finance





FIN009699

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands

| | Year ended December 31, 2005 | Year ended December 31, 2004 |
|---|---|---|
| Revenues | $ 6,877 | $ 7,099 |
| Patent license revenues | 8,000 | - |
| Total revenues | 14,877 | 7,099 |
| Cost of revenues | 2,200 | 1,638 |
| Gross profit | 12,677 | 5,461 |
| Operating expenses: | | |
| Research and development | 3,669 | 4,163 |
| Selling and marketing, net | 7,133 | 6,768 |
| General and administrative | 2,721 | 2,279 |
| Total operating expenses | 13,523 | 13,210 |
| Operating loss | (846) | (7,749) |
| Financial and other income (expenses), net | 129 | (69) |
| Loss before taxes on income | (717) | (7,818) |
| Taxes on income | 37 | 26 |
| Net loss | $ (754) | $ (7,844) |

The accompanying notes are an integral part of the consolidated financial statements.

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)

U.S. dollars in thousands (except share data)

| | Common stock | | Preferred stock | | Additional paid-in capital **) | Treasury stock | Accumulated deficit | Total stockholders' equity (deficiency) |
|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | | | | |
| Balance as of January 1, 2004 | 187,946 | $ 3 | 10,428,196 | $ 104 | $ 29,075 | $ (9) | $ (31,192) | $ (2,019) |
| Options exercised | 59,244 | *) - | - | - | 4 | - | - | 4 |
| Issuance of Series D Preferred stock, net | - | - | 6,426,735 | 64 | 9,825 | - | - | 9,889 |
| Net loss | - | - | - | - | - | - | (7,844) | (7,844) |
| Balance as of December 31, 2004 | 247,190 | 3 | 16,854,931 | 168 | 38,904 | (9) | (39,036) | 30 |
| Conversion of convertible loan | - | - | 964,011 | 10 | 1,490 | - | - | 1,500 |
| Issuance of Series D Preferred stock, net | - | - | 1,285,347 | 13 | 1,920 | - | - | 1,933 |
| Options exercised | 99,875 | 1 | - | - | 17 | - | - | 18 |
| Net loss | - | - | - | - | - | - | (754) | (754) |
| Balance as of December 31, 2005 | 347,065 | $ 4 | 19,104,289 | $ 191 | $ 42,331 | $ (9) | $ (39,790) | $ 2,727 |

*) Represents an amount lower than $ 1.

**) Reclassified.

The accompanying notes are an integral part of the consolidated financial statements.

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, 2005 | Year ended December 31, 2004 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (754) | $ (7,844) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | 284 | 227 |
| Decrease (increase) in trade receivables, net | 1,040 | (356) |
| Increase in deferred costs *) | (1,180) | (268) |
| Increase in prepaid expenses and other accounts receivable *) | (75) | (52) |
| Increase in inventory | (211) | (209) |
| Increase in trade payables | 40 | 94 |
| Increase (decrease) in employees and payroll accruals and accrued expenses and other liabilities | (283) | 43 |
| Increase in deferred revenues | 1,800 | 629 |
| Increase (decrease) in severance pay, net | (31) | 55 |
| Net cash provided by (used in) operating activities | 630 | (7,681) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (149) | (411) |
| Disposal of property and equipment | 1 | - |
| Decrease (increase) in long-term deposits and prepaid expenses *) | 94 | (27) |
| Net cash used in investing activities | (54) | (438) |
| Cash flows from financing activities: | | |
| Principal payments of obligation under capital leasing contracts | - | (13) |
| Convertible loan received | 1,500 | - |
| Proceeds from issuance of shares, net | 1,933 | 9,897 |
| Options exercised | 18 | (4) |
| Net cash provided by financing activities | 3,451 | 9,880 |
| Increase in cash and cash equivalents | 4,027 | 1,761 |
| Cash and cash equivalents at the beginning of the year | 4,499 | 2,738 |
| Cash and cash equivalents at the end of the year | $ 8,526 | $ 4,499 |
| Supplemental disclosure of non-cash financing activities: | | |
| Options exercised but not yet paid | $ - | $ 4 |
| Conversion of convertible loan into Preferred stock | $ (1,500) | $ - |

*) Reclassified.

The accompanying notes are an integral part of the consolidated financial statements.

[redacted]



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL

a. Finjan Software, Inc. ("Finjan") and its subsidiaries (together "the Company" or "the Finjan Group") are engaged in the development, marketing and sale of behavior-based security solutions for enterprises, small and medium-sized business and home users. Finjan's security solutions are based on Finjan's patented Application-Level Behavior Blocking which provides protection against both known and unknown attacks, the first time they strike (e.g. Spyware, phishing, malicious code, viruses, worms and Trojans). Finjan's behavior-based security solutions integrate anti-virus, anti-spam, URL filtering and document protection.

Finjan, a Delaware corporation, was incorporated in June 2002 and commenced operations in September 2002. As a result of a reorganization that occurred in 2002, Finjan became the parent company of the following wholly-owned subsidiaries:

1. Finjan Software Ltd. ("Finjan Ltd." or "the Israeli subsidiary") was incorporated in Israel and commenced operations in January 1996. As a result of the reorganization, Finjan became the parent company of Finjan Ltd. owning approximately 97% of its shares. In March 2004, Finjan purchased the balance of Finjan Ltd.'s shares. As a result, Finjan Ltd. became a wholly-owned subsidiary of Finjan.

2. Finjan Inc. ("Finjan Inc.") was incorporated in the State of California as a wholly-owned subsidiary of Finjan Ltd. and commenced operations in January 1997. During 1998, Finjan Inc. was reincorporated in the State of Delaware. In October 2003, Finjan Ltd. transferred all of its shares in Finjan Inc. to Finjan. As a result of this transfer, Finjan Inc. became a wholly-owned subsidiary of Finjan.

3. Finjan Software (UK) Ltd. ("Finjan UK") was incorporated under the laws of the United Kingdom, as a wholly-owned subsidiary of Finjan Ltd. in March 2003. In October 2003, Finjan Ltd. transferred its share in Finjan UK to Finjan. As a result of this transfer, Finjan UK became a wholly-owned subsidiary of Finjan. Finjan UK is engaged in marketing the Company's products in England.

4. Finjan Software GmbH ("Finjan GmbH") was incorporated in August 2004 under the laws of Germany as a wholly-owned subsidiary of Finjan. Finjan GmbH is engaged in marketing the Company's products in Germany, Austria and Switzerland.

b. In June 2004, the Company signed a Stock Purchase Agreement ("the SPA") with certain existing shareholders and a major new investor ("the Investor").

According to the SPA, the Company issued 6,426,735 shares of Series D Preferred stock at a price per share of $ 1.556 for a total consideration of $ 10,000, net of $ 111 in issuance expenses. In connection with the SPA, the Company has restated its Certificate of Incorporation in order to adjust the rights associated with the Preferred stock.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

### NOTE 1:- GENERAL (Cont.)

c. On June 21, 2005, the Company signed a convertible loan agreement ("the Loan") with certain stockholders, according to which the stockholders agreed to lend the Company an aggregate amount of $ 1,500 ("the principal amount"). The principal amount of the Loan bore interest at an annual rate of 8% paid upon the earlier of repayment or conversion of the Loan.

On June 30, 2005, the Company entered into a Stock Purchase Agreement ("the 2005 SPA") whereby it issued to a new investor 1,285,347 shares of Series D Preferred stock of $ 0.01 par value each in an aggregate amount of $ 2,000.

As part of the SPA, the principal amount under the Loan was converted into 964,011 shares of Series D Preferred stock, at the same terms and conditions as provided to the new investor under the 2005 SPA.

On June 30, 2005, Finjan Ltd. entered into a patent license agreement ("the License Agreement") with the New Investor, according to which simultaneously with the closing of the 2005 SPA, Finjan Ltd. on behalf of itself and its affiliates, shall provide to the New Investor and its affiliates, effective as of the payment date, a certain limited, worldwide, nonexclusive, nontransferable, royalty-free license to Finjan Ltd.'s patents, pursuant to the terms and conditions of the License Agreement in consideration of $ 8,000.

### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The significant policies followed in the preparation of the consolidated financial statements are:

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reporting of amounts for revenues and expenses during the reported period. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The functional currency of the Company is the U.S. dollar, as the U.S. dollar is the currency of the primary economic environment in which the Company operates and expects to continue to operate in the foreseeable future. The majority of the Company's operations are currently conducted by the Israeli subsidiary and most of the Israeli expenses are currently paid in new Israeli shekels ("NIS"); however, these operations are denominated and determined in U.S. dollars. Most of the Company's revenues are generated in U.S. dollars, its cash is invested almost entirely in U.S. dollar deposits and its other financing activities including loans and equity transactions are made in U.S. dollars.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company's transactions and balances denominated in U.S. dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured to U.S. dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52 of the U.S. Financial Accounting Standards Board ("FASB"). All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of Finjan Software Inc. and its wholly-owned subsidiaries, Finjan Ltd., Finjan Inc., Finjan U.K. and Finjan GmbH. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are considered to be highly liquid investments, which include unrestricted short-term bank deposits with original maturities of three months or less.

e. Long-term lease deposits:

Long-term lease deposits include long-term deposits for the leasing of facilities and motor vehicles, presented at their cost.

f. Property and equipment:

Property and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

| | % |
|---|---|
| Computers and peripheral equipment | 33 |
| Office furniture and equipment | 6 - 20 |
| Leasehold improvements | Over the term of the lease |

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No.144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No.144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2005, no impairment losses have been identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. Research and development costs:

SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon the completion of a working model. The Company does not incur material costs between the completion of the working model and the point at which the product is ready for general release. Therefore, research and development costs are charged to the statement of operations as incurred.

h. Concentrations of credit risk:

SFAS No. 105, "Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk", requires disclosure of any significant off-balance-sheet and credit risk concentrations. The Company has no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

Cash and cash equivalents are invested in major banks in Israel, Germany, United Kingdoms and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers located in Europe and the U.S. The Company performs ongoing credit evaluations of their customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to specific amounts that the Company has determined to be doubtful of collection.

i. Revenue recognition:

The Company derives its revenue from sales of hardware appliances, software license fees and sub-license fees of its products, training, maintenance and support. In 2005, the Company adopted a new business model, according to which the Company provides its product for a limited subscription period. The Company sells its products indirectly through distributors and resellers, and directly to end-users, all of whom are considered end-users.

[redacted]



NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenue from software, software-related and patent license fees are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectability is probable.

The Company recognizes software license revenue in accordance with Statement of Position SOP 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair value of the elements. When contracts contain multiple elements wherein Vendor Specific Objective Evidence (VSOE) of fair value exists for all undelivered elements, the Company accounts for the delivered elements in accordance with the "Residual Method" prescribed by SOP 98-9. Maintenance and support revenue included in these arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The VSOE of fair value of the undelivered elements (maintenance, support and services) is determined based on the price charged for the undelivered element when sold separately.

In 2005, the Company adopted a new business model, according to which the Company provides its products for a limited subscription period. According to Emerging Issues Task Force 03-5, "Application of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software" ("EITF 03-5") in an arrangement that includes software that is more than incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. The Company's products consist of appliances upon which the Company's software is installed. The software, hardware appliance and maintenance are a bundled solution and are essential to the functionality of each other; therefore related revenues are recognized together throughout the service period of each agreement.

Service revenue is primarily comprised of revenue from standard maintenance agreements, and training fees. The Company recognizes revenues from maintenance over the contractual period of the maintenance agreement. Training services are billed on a per session basis. The Company recognizes service revenue from training when provided to the customer.

Deferred revenue includes amounts invoiced to customers for which revenue has not yet been recognized. Related costs of these deferred revenues are being deferred as well, and recognized throughout the service agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44") in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company's stock options is less than the market price of the underlying stocks on the date of grant, compensation expense is recognized.

The Company applies SFAS No. 123, "Accounting for Stock-Based Compensation" and Emerging Issues Task Force ("EITF") 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or In Conjunction with Selling Goods or Services", with respect to warrants and options issued to non-employees and consultants. SFAS No. 123 requires the use of option valuation models to measure the fair value of the warrants at the grant date.

In December 2002, the FASB issued SFAS 148; "Accounting for Stock Based Compensation Transition and Disclosure - an Amendment of FASB Statement No. 123" ("SFAS 148"). SFAS 148 permits two additional transition methods for entities that adopt the fair value based method of accounting for stock-based employee compensation. The Statement also requires new disclosures about the ramp-up effect of stock-based employee compensation on reported results. The Statement also requires that those effects be disclosed more prominently by specifying the form, content, and location of those disclosures. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. As of the balance sheet date, the Company continues to apply APB 25.

Pro forma information regarding the Company's net loss and net loss per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123. However, the pro-forma information required by SFAS No. 123 is not disclosed due to its immateriality.

k. Severance pay:

Finjan Ltd.'s liability for severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. Finjan Ltd.'s liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense for the years ended December 31, 2005 and 2004, amounted to approximately $ 228 and $ 261, respectively.

l. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, prepaid expenses and other accounts receivable, trade payables, employees and payroll accruals, accrued expenses and other liabilities and current maturities of capital lease obligations approximate their fair value due to the short-term maturity of such instruments.

The carrying amount of the Company's long-term capital lease obligations approximates its fair value. The fair value was estimated using the cash flow analysis.

m. Impact of recently issued accounting standards:

In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4." ("SFAS No. 151"). SFAS No. 151 amends Accounting Research Bulletin ("ARB") No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect that the adoption of SFAS No. 151 will have a material effect on its financial position or results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standard No. 153, "Exchanges of Non-monetary Assets, an Amendment of APB Opinion No. 29" ("SFAS 153"). The guidance in APB Opinion No. 29, "Accounting for Non-monetary Transactions" ("APB 29"), is based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. APB 29 included certain exceptions to that principle. SFAS 153 amends APB 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for non-monetary assets exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not expect that the adoption of SFAS 153 will have a material effect on its financial position or results of operations.



 

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

On December 16, 2004, the Financial Accounting Standards Board issued Statement No. 123 (revised 2004), "Share-Based Payment" ("Statement 123(R)"), which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("Statement 123"). Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values while Statement 123(R) requires all share-based payments to employees to be recognized based on their fair values. Statement 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new Standard will be effective for the Company in the first fiscal year beginning after January 1, 2006. The Company is still assessing the impact, if any, that the adoption of Statement 123(R) will have on the Company's financial statements.

In March 2005, the SEC released SEC Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"). SAB 107 provides the SEC staff's position regarding the application of SFAS 123(R) and contains interpretive guidance related to the interaction between SFAS 123(R) and certain SEC rules and regulations, and also provides the SEC staff's views regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosures made relating to the accounting for share-based payment transactions. The Company is currently reviewing the effect of SAB 107, however it does not believe that SAB 107 will have a material effect on its financial position, results of operations or cash flows.

In May 2005, the FASB issued Statement of Financial Accounting Standard No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections", a replacement of APB No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. APB No. 20 previously required that most voluntary changes in accounting principles be recognized by including in net income for the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retroactive application to prior periods' financial statements of a voluntary change in accounting principles unless it is impracticable. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 3:- PROPERTY AND EQUIPMENT

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Cost: | | |
| Computers and peripheral equipment | $ 1,443 | $ 1,326 |
| Office furniture and equipment | 165 | 195 |
| Leasehold improvements | 67 | 61 |
| | 1,675 | 1,582 |
| Accumulated depreciation | 1,189 | 960 |
| Depreciated cost | $ 486 | $ 622 |

Depreciation expenses for the years ended December 31, 2005 and 2004 were $ 284 and $ 227, respectively.

NOTE 4:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company rents its facilities under operating leases in Israel, the United Kingdom, Germany and the United States.

Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2005, are as follows:

| | |
|---|---|
| 2006 | $ 723 |
| 2007 | 465 |
| 2008 | 109 |
| | $ 1,297 |

Rent expenses for the years ended December 31, 2005 and 2004, were $ 435 and $ 405, respectively.

b. During the years 2005 and 2004, the Company provided bank guarantees to its lessor of leased accommodation in the amounts of $ 106 and $ 114, respectively.

c. Legal claim:

During 2003, the Company received a letter from a third party, alleging to a potential infringement of one of that party's patents. The Company responded that it does not believe that its product infringes the abovementioned patent. No further action has been taken to date. The Company does not believe that this claim has any merit, and the Company will vigorously defend itself against the claim presented therein, if necessary. The Company does not believe that this legal claim will have any impact on its financial statements.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands (except share and per share data)

NOTE 5:- STOCK CAPITAL

a. Composition of stock capital of Finjan Software, Inc:

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | Authorized | Issued and outstanding | Authorized | Issued and outstanding |
| | Number of shares | | | |
| Common stock (1) | 27,000,000 | 347,065 | 27,000,000 | 247,190 |
| Series A Preferred stock (2) | 226,226 | 226,226 | 226,226 | 226,226 |
| Series B Preferred stock (2) | 2,574,493 | 2,574,493 | 2,574,493 | 2,574,493 |
| Series C Preferred stock (2) | 7,627,477 | 7,627,477 | 7,627,477 | 7,627,477 |
| Series D Preferred stock (2) | 8,676,093 | 8,676,093 | 7,712,082 | 6,426,735 |
| | 46,104,289 | 19,451,354 | 45,140,278 | 17,102,121 |

(1) Common stock:

Common stock confers upon its holders, pari passu, the right to receive notice of, and to participate in, all general meetings of the Company, to vote in such meetings, to receive dividends, and to participate in the distribution of the surplus assets of the Company in the event of liquidation of the Company.

(2) Preferred stock:

Series A, B, C and D Preferred stock confer upon their holders the same rights conferred by the Common stock. In addition, each share of Preferred A, C and D stock is convertible into Common stock on a one for one basis and each share of Preferred B stock is convertible into 1.23 shares of Common stock. Each share of Preferred A, B, C and D stock is convertible into Common stock at the applicable conversion price at the option of the holder and automatically upon the earlier of (i) a qualified initial public offering ("IPO"), which yields not less than $ 25,000 in net proceeds to the Company, or (ii) with respect to each class, a written consent or agreement of holders of majority of the outstanding shares of such class.

Holders of shares of Series D Preferred stock are entitled to a dividend prior to the Series A, B and C Preferred stock and the Common stock, when and if declared, at a rate of $ 0.1245 per share per annum. Holders of Series C Preferred stock are entitled to receive a dividend, prior to the Series A and B Preferred stock and the Common stock, when and if declared, at a rate of $ 0.091 per share per annum. Such dividends shall not be cumulative.

[redacted]



NOTE 5: - STOCK CAPITAL (Cont.)

In the event of a liquidation or deemed liquidation of the Company, in which the value of the assets available for distribution among the stockholders is $ 80,000 or less, then all assets available for distribution between the stockholders will be distributed in the following order: (i) Series D Preferred stock shall be entitled to receive, prior to any other Common or Preferred stock, an amount per share equal to $ 1.5560 (subject to adjustments) for each outstanding share of Preferred D stock; (ii) Series C Preferred stock shall be entitled to receive, prior to Series A and B Preferred stock and Common stock, an amount per share equal to $ 1.1382 (subject to adjustments). for each outstanding share of Preferred C stock; (iii) Series B Preferred stock shall be entitled to receive, prior to Preferred A stock and Common stock, an amount per share equal to $ 1.4014 for each outstanding share of Preferred B stock (subject to adjustments); (iv) Series A Preferred stock shall be entitled to receive, prior to Common stock, an amount per share equal to $ 37.6 for each outstanding share of Preferred A stock; (v) upon completion of phases (i) to (iv) all remaining assets will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis. In the event that the value of the assets available for distribution exceeds $ 80,000, then Series A, B, C and D Preferred stock shall not be entitled to receive the liquidation preference described above, rather amounts available for distribution will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis.

b. Stock Option Plans:

As part of the reorganization, all options convertible into Common B stock in Finjan Ltd. under Finjan Ltd.'s 1996 Stock Option Plan ("the 1996 Plan") were converted into options to purchase Common stock of Finjan Software, Inc under the 2003 Plan (as defined below).

In December 2003, the Company's Board of Directors approved a new stock option plan ("the 2003 Plan"), and chose the Capital Gain Course, pursuant to the provisions of Section 102 of Israel's Income Tax Ordinance. Options granted under the 2003 Plan vest over a period of four years, and expire no later than 10 years from the date of grant. As of December 31, 2005, the Company reserved 4,696,814 shares of Common stock for exercise of options under the 2003 Plan. Pursuant to the 2003 Plan, the Company granted 3,908,495 options to employees of the Company and there are 788,319 options to purchase shares available for future grants.

[redacted]



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**U.S. dollars in thousands (except share and per share data)**

### NOTE 5:- STOCK CAPITAL (Cont.)

A summary of the stock option activities in 2005 and 2004 is as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at beginning of year | 2,777,159 | $ 0.16 | 2,435,791 | $ 0.17 |
| Granted | 1,963,484 | $ 0.16 | 720,000 | $ 0.14 |
| Exercised | (99,875) | $ 0.14 | (59,244) | $ 0.14 |
| Forfeited | (732,273) | $ 0.18 | (319,388) | $ 0.15 |
| Outstanding at end of year | 3,908,495 | $ 0.16 | 2,777,159 | $ 0.16 |

The options outstanding as of December 31, 2005, have been separated into ranges of exercise price as follows:

| Exercise price | Options outstanding as of December 31, 2005 | Weighted average remaining contractual life | Weighted average exercise price | Exercisable as of December 31, 2005 | Weighted average exercise price of options exercisable |
|---|---|---|---|---|---|
| | Amount | Years | | | |
| $ 0.14 | 1,804,647 | 8.02 | $ 0.14 | 1,674,548 | $ 0.14 |
| $ 0.16 | 2,101,536 | 9.91 | $ 0.16 | 59,349 | $ 0.16 |
| $ 3.00 | 917 | 8.83 | $ 3.00 | 917 | $ 3.00 |
| $ 14.00 | 50 | 8.83 | $ 14.00 | 50 | $ 14.00 |
| $ 23.00 | 80 | 8.83 | $ 23.00 | 80 | $ 23.00 |
| $ 25.00 | 1,265 | 8.83 | $ 25.00 | 1,265 | $ 25.00 |
| | 3,908,495 | 9.04 | $ 0.16 | 1,736,209 | $ 0.16 |

Options to consultants:

| Issuance date | In connection with | Number of options granted | Options exercisable | Exercise price per share | Exercisable through |
|---|---|---|---|---|---|
| 10/25/2004 | Consultants | 3,000 | 875 | $ 0.16 | 10/31/2014 |
| 10/25/2004 | Consultants | 102 | 102 | $ 3.00 | 10/31/2014 |
| 10/25/2004 | Consultants | 100 | 100 | $ 25.00 | 10/31/2014 |
| 9/25/2005 | Consultants | 7,500 | - | $ 0.16 | 9/30/2015 |
| | | 10,702 | 1,077 | $ 0.42 | |

[redacted]





NOTE 5:- STOCK CAPITAL (Cont.)

c. Purchase offer:

On October 27, 2003, the Company offered to all stockholders of Finjan Ltd. other than the Company ("the stockholders"), to purchase all of their holdings in Finjan Ltd. ("the shares"), approximately 107,965 shares at a price per share of $ 0.14. Stockholders holding more than 90% of the shares agreed to sell their shares to the Company at the offered price per share, as a result, the Company was able to enforce the sale on all other stockholders. The transaction was completed during March 2004.

d. Treasury stock:

On December 30, 2003, the Company purchased 66,296 shares of its outstanding Common stock for a total consideration of $ 9. These shares were recorded as Treasury stock.

NOTE 6:- TAXES ON INCOME

a. Measurement of results for tax purposes under the Israeli Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes of Finjan Ltd. are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. As explained in Note 2b, the financial statements are presented in U.S. dollars. The difference between the annual change in the CPI and in the NIS/dollar exchange rate causes a difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities.

During 2005, Finjan Ltd. applied to the Israeli Income Tax Authorities in order to report its annual income filings for tax purposes in U.S. dollars. As a result, commencing with fiscal year 2005, Finjan Ltd. will report to the Israeli Income Tax Authorities in U.S. dollars.

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

On October 13, 1996, the production facilities of Finjan Ltd. were granted the status of an "Approved Enterprise" under the Law. On October 10, 2001, an expansion of the "Approved Enterprise" was granted to the Company.

According to the provisions of the Law, the Company has chosen to enjoy the "Alternative Benefits" track and, accordingly, its income from the "Approved Enterprise" is tax-exempt for a period of two years, commencing in the first year the Company has taxable income, and subject to an additional period of five to eight years of reduced tax rates between 10% to 25%, depending upon the proportion of foreign ownership in the Company in each tax year. The period of tax benefits is subject to limits of the earlier of 12 years from the commencement of production, or 14 years, from the approval date. Given the aforementioned conditions, the period of benefits relating to these investment programs will expire in the year 2015.



 

NOTE 6:- TAXES ON INCOME (Cont.)

In the event of distribution of cash dividends from income that is tax exempt as mentioned above, Finjan Ltd. would have to pay income tax equal to 10% to 25% of the amount distributed. The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting Finjan Ltd. to taxes only upon the complete liquidation of Finjan Ltd.

Finjan Ltd. currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

The entitlement to the above benefits is conditional upon Finjan Ltd.'s fulfilling the conditions stipulated by the above law, regulations published their under and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and Finjan Ltd. may be required to refund the amount of the benefits, in whole or in part, including interest. Management believes that Finjan Ltd. has complied with all relevant conditions.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as an "Approved Enterprise", such as provisions generally requiring that at least 25% of the "Approved Enterprise" income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore the Israeli subsidiary's existing "Approved Enterprise" will generally not be subject to the provisions of the Amendment.

Should Finjan Ltd. derive income from sources other than the "Approved Enterprise" during the relevant period of benefits, such income will be taxable at the regular corporate tax rate of 34%, which will be reduced to 31% in 2006, and will be further reduced to 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010.

c. Tax assessments:

Finjan Ltd. has received final tax assessment through December 31, 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

## NOTE 6:- TAXES ON INCOME (Cont.)

d. Net operating losses carryforwards:

As of December 31, 2005, Finjan Ltd. has accumulated losses for Israeli tax purposes which may be carried forward and offset against taxable income for an indefinite period in the future. The Company expects that during the period in which these tax losses are utilized, its income would be substantially tax-exempt. Accordingly, there will be no tax benefit available from such losses and no deferred income taxes have been included in these financial statements.

As of December 31, 2005, Finjan and Finjan Inc. have combined losses which may be carried forward and offset against taxable income in the future with limitation regarding their amount and their offset period.

e. Deferred taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for income tax purposes.

The Company has provided valuation allowances in respect of deferred tax assets, since it has a history of losses. Management currently believes that it is more likely than not that the deferred tax regarding the loss carry forwards and other temporary differences will not be realized in the near future.

## NOTE 7:- SUBSEQUENT EVENTS

On January 31, 2006 ("the Closing Date"), the Company entered into Stock Purchase Agreement ("the 2006 SPA") whereby it issued to a new and existing investors 6,089,191 shares of Series D Preferred stock at par value of $ 0.01 in an aggregate amount of $ 9,475.

At a deferred closing ("the Deferred Closing") to be held not later than 60 days following the Closing Date, the Company may sell up to an additional 337,544 shares of Series D Preferred stock at the same price per share and under the same terms and conditions as provided to the investors at the Closing Date, in an aggregate amount of $ 525.

If no additional investor subscribes for the Deferred Closing or if subscription is for less than the full shares of the Deferred Closing, then two existing investors shall automatically subscribe for the remaining shares, to be allocated between them pursuant to the ratio of shares being acquired by each of them at the Closing Date.

- - - - - - - - - - - - - - -

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# Exhibit 4

# FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED FINANCIAL STATEMENTS

## AS OF DECEMBER 31, 2004

Joint Trial Exhibit
**JTX-29**
Case No. 06-369 GMS

[redacted]

# FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED FINANCIAL STATEMENTS

## AS OF DECEMBER 31, 2004

## IN U.S. DOLLARS

### INDEX



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[redacted]

ERNST & YOUNG

Kost Forer Gabbay & Kasierer
3 Aminadav St
Tel-Aviv 67067, Israel

Phone 972-3-6232525
Fax 972-3-5622555

# REPORT OF INDEPENDENT AUDITORS

To the Stockholders of

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of Finjan Software, Inc. and its subsidiaries (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity (deficiency) and cash flows for each of the two years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2004 and 2003, and the consolidated results of its operations and cash flows for each of the two years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1d to the financial statements, the Company has incurred recurring operating losses and negative cash flow from operating activities. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Tel-Aviv, Israel
February 28, 2005

Kost Forer Gabbay and Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

| | Note | December 31, 2004 | December 31, 2003 |
|---|---|---|---|
| **ASSETS** | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | | $ 4,499 | $ 2,738 |
| Trade receivables (net of allowance for doubtful accounts of $ 10 and $ 23 as of December 31, 2004 and 2003, respectively) | | 3,463 | 3,107 |
| Prepaid expenses and other accounts receivable | | 436 | 256 |
| Total current assets | | 8,398 | 6,101 |
| INVENTORY | | 209 | - |
| LONG-TERM DEPOSITS AND PREPAID EXPENSES | | 309 | 142 |
| SEVERANCE PAY FUND | | 374 | 282 |
| PROPERTY AND EQUIPMENT, NET | 3 | 622 | 438 |
| Total assets | | $ 9,912 | $ 6,963 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)** | | | |
| CURRENT LIABILITIES | | | |
| Current maturities of obligation under capital leasing contracts | 4 | $ - | $ 11 |
| Trade payables | | 593 | 499 |
| Employees and payroll accruals | | 952 | 642 |
| Deferred revenues | | 4,374 | 4,305 |
| Accrued expenses and other liabilities | | 1,180 | 1,447 |
| Total current liabilities | | 7,099 | 6,904 |
| LONG-TERM LIABILITIES: | | | |
| Capital lease obligations, net of current maturities | 4 | - | 2 |
| Long-term deferred revenues | | 2,227 | 1,667 |
| Accrued severance pay | | 556 | 409 |
| Total long-term liabilities | | 2,783 | 2,078 |
| COMMITMENTS AND CONTINGENCIES | 5 | | |
| STOCKHOLDERS' EQUITY (DEFICIENCY): | 6 | | |
| Stock capital - | | | |
| Common stock of $ 0.01 par value: Authorized: 27,000,000 and 15,000,000 shares at December 31, 2004 and 2003, respectively; Issued and outstanding: 247,190 and 187,946 shares at December 31 2004 and 2003, respectively. | | 3 | 3 |
| Series A, B, C and D Preferred stock of $ 0.01 par value Authorized: 18,140,278 and 10,428,196 shares at December 31, 2004 and 2003, respectively; Issued and outstanding. 16,854,931 and 10,428,196 shares at December 31, 2004 and 2003, respectively. Aggregate liquidation preference of $ 30,796 as of December 31, 2004 | | 168 | 104 |
| Additional paid-in capital | | 38,894 | 29,061 |
| Treasury shares | | (9) | (9) |
| Receipts on account of shares | | 10 | 14 |
| Accumulated deficit | | (39,036) | (31,192) |
| Total stockholders' equity (deficiency) | | 30 | (2,019) |
| Total liabilities and stockholders equity (deficiency) | | $ 9,912 | $ 6,963 |

The accompanying notes are an integral part of the consolidated financial statements.

| | | |
|---|---|---|
| February 28, 2005 | | |
| Date of approval of the financial statements | Shlomo Touboul<br>Chief Executive Officer | David Ater<br>Chief Financial Officer |

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands

| | Year ended December 31, 2004 | Year ended December 31, 2003 |
|---|---|---|
| Revenues | $ 7,099 | $ 5,889 |
| Cost of revenues | 1,638 | 1,333 |
| Gross profit | 5,461 | 4,556 |
| Operating expenses: | | |
| Research and development | 4,163 | 3,064 |
| Selling and marketing, net | 6,768 | 6,338 |
| General and administrative | 2,279 | 1,662 |
| Total operating expenses | 13,210 | 11,064 |
| Operating loss | (7,749) | (6,508) |
| Financial and other expenses, net | 69 | 92 |
| Net loss before taxes on income | (7,818) | (6,600) |
| Taxes on income | 26 | 7 |
| Net loss | $ (7,844) | $ (6,607) |

The accompanying notes are an integral part of the consolidated financial statements.

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIENCY)

U.S. dollars in thousands (except share data)

| | Preferred stock | | Common stock | | Additional paid-in capital | Treasury stock | Receipts on account of shares | Accumulated deficit | Total stockholders' equity (deficiency) |
|---|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | | | | | |
| Balance as of January 1, 2003 | 10,428,196 | $ 104 | 254,242 | $ 3 | $ 29,061 | $ - | $ 14 | $ (24,585) | $ 4,597 |
| Purchase of Treasury stock | - | - | (66,296) | *) - | - | (9) | - | - | (9) |
| Net loss | - | - | - | - | - | - | - | (6,607) | (6,607) |
| Balance as of December 31, 2003 | 10,428,196 | 104 | 187,946 | 3 | 29,061 | (9) | 14 | (31,192) | (2,019) |
| Options exercised | - | - | 59,244 | *) - | 8 | - | (4) | - | 4 |
| Issuance of Series D Preferred stock, net | 6,426,735 | 64 | - | - | 9,825 | - | - | - | 9,889 |
| Net loss | - | - | - | - | - | - | - | (7,844) | (7,844) |
| Balance as of December 31, 2004 | 16,854,931 | $ 168 | 247,190 | $ 3 | $ 38,894 | $ (9) | $ 10 | $ (39,036) | $ 30 |

*) Represents an amount lower than $ 1.

The accompanying notes are an integral part of the consolidated financial statements.

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

| | Year ended December 31, 2004 | Year ended December 31, 2003 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (7,844) | $ (6,607) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 227 | 122 |
| Increase in trade receivables | (356) | (1,079) |
| Increase in prepaid expenses and other accounts receivable | (180) | (74) |
| Increase in trade payables | 94 | 115 |
| Increase in employee and payroll accruals and accrued expenses and other liabilities | 43 | 1,039 |
| Increase in deferred revenues | 629 | 2,864 |
| Increase in severance pay, net | 55 | 50 |
| Increase in inventory | (209) | - |
| Net cash used in operating activities | (7,541) | (3,570) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (411) | (325) |
| Increase in long-term deposits and prepaid expenses | (167) | (134) |
| Net cash used in investing activities | (578) | (459) |
| Cash flows from financing activities: | | |
| Principal payments of obligation under capital leasing contracts | (13) | (7) |
| Proceeds from issuance of shares, net | 9,897 | - |
| Options exercised | (4) | - |
| Purchase of Treasury stock | - | (9) |
| Net cash provided by (used in) financing activities | 9,880 | (16) |
| Increase (decrease) in cash and cash equivalents | 1,761 | (4,045) |
| Cash and cash equivalents at the beginning of the year | 2,738 | 6,783 |
| Cash and cash equivalents at the end of the year | $ 4,499 | $ 2,738 |
| Supplemental disclosure of non-cash financing activities: | | |
| Options exercised but not yet paid | 4 | - |

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 1:- GENERAL

a. Finjan Software, Inc. ("Finjan") and its subsidiaries ("the Company" or "the Finjan Group") are engaged in the development, marketing and sale of behavior-based security solutions for enterprises, small and medium-sized business and home users. Finjan's security solutions, using its patented Application-Level Behavior Blocking provide protection against both known and unknown attacks, the first time they strike (e.g. Spyware, phishing, malicious code, viruses, worms and Trojans). Finjan's behavior – based security solutions integrate anti-virus, anti-spam, URL filtering and document protection.

Finjan, a Delaware Corporation, was incorporated in June 2002 and commenced operations in September 2002. As a result of the reorganization described in Note 1b, Finjan became the parent company of the following wholly owned subsidiaries:

1. Finjan Software Ltd. ("Finjan Ltd." or "the Israeli subsidiary") - Finjan Ltd. was incorporated in Israel and commenced operations in January 1996. As a result of the reorganization, which took place in September 2002, Finjan became the parent company of Finjan Ltd. owning approximately 97% of its shares. In March 2004, Finjan purchased the balance of Finjan Ltd.'s shares. As a result Finjan Ltd. became a wholly owned subsidiary of Finjan.

2. Finjan Inc. ("Finjan Inc.") - Finjan Inc. was incorporated in the State of California as a wholly owned subsidiary of Finjan Ltd. and commenced operations in January 1997. During 1998, Finjan. Inc. was reincorporated in the State of Delaware. In October 2003 Finjan Ltd. transferred all of its shares in Finjan Inc. to Finjan. As a result of this transfer, Finjan Inc. became a wholly owned subsidiary of Finjan.

3. Finjan Software (UK) Ltd. ("Finjan UK") - Finjan UK was incorporated under the laws of the United Kingdom, as a wholly owned subsidiary of Finjan Ltd. in March 2003. In October 2003, Finjan Ltd. transferred its share in Finjan UK to Finjan. As a result of this transfer, Finjan UK became a wholly owned subsidiary of Finjan. Finjan UK is engaged in marketing the Company's products in England.

4. Finjan Software GmbH ("Finjan GmbH") - Finjan GmbH was incorporated in August 2004 under the laws of Germany as a wholly-owned subsidiary of Finjan. Finjan GmbH is engaged in marketing the Company's products in Germany, Austria and Switzerland.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

### NOTE 1:- GENERAL

b. In September 2002, Finjan entered into a stock purchase agreement ("the SPA") whereby it issued to investors 5,870,317 shares of Series C Preferred stock of Finjan at a price per share of $ 1.1382, for a total consideration of approximately $ 6,700. In addition, a loan received by Finjan Ltd. in March 2002 was assigned to Finjan and converted into 1,757,160 shares of Series C Preferred stock of Finjan. As a condition to the SPA, a reorganization agreement was signed in September 2002 between Finjan, Finjan Ltd.'s stockholders and Finjan Ltd., according to which a reorganization in the Finjan Group structure was consummated. As part of the reorganization, a new Delaware corporation, Finjan Software, Inc. was established, and it was agreed that (i) each share of outstanding Preferred A, B, C and D stock of Finjan Ltd. (assuming conversion into Common stock) was exchanged for one Series A Preferred stock of Finjan; (ii) each outstanding share of Series E Preferred stock of Finjan Ltd. was exchanged for one share of Series B Preferred stock of Finjan; (iii) each outstanding warrant or option for Common stock or Preferred stock of Finjan Ltd. shall become exercisable for the same class of securities the holder of such options or warrants has obtained in the reorganization (see also Note 6); and (iv) 254,242 outstanding shares of common A and B stock of Finjan Ltd. out of a total 362,232 shares of common A and B stock were exchanged for 254,242 shares of Common stock of Finjan. In addition, in accordance with the SPA, Finjan issued, at no consideration, 31,850 shares of Series B Preferred stock of Finjan to certain stockholders as a result of the antidilution protection provided in Finjan Ltd.'s Articles of Association. As part of the reorganization a share exchange agreement was signed with a Common A stockholder (the "Stockholder") of Finjan Ltd. whereby 105,595 Common A stock of Finjan Ltd. held by the Stockholder were transferred to Finjan in consideration for the issuance of Common stock of Finjan on a one to one basis. This reorganization has been accounted for in a manner similar to a pooling of interest.

c. In June 2004, the Company signed a stock purchase agreement ("the 2004 SPA") with certain existing shareholders and a major new investor ("the New Investor").

According to the 2004 SPA the Company issued 6,426,735 shares of Series D Preferred stock at a price per share of $ 1.556 for a total consideration of $ 10,000, net of $ 111 in issuance expenses. In connection with the SPA, the Company has restated its Certificate of Incorporation in order to adjust the rights associated with the Preferred stock.

d. As of December 31, 2004, the Company's stockholders' equity amounted to $ 30. In addition, in 2004, the Company incurred operating losses in the amount of approximately $ 7,844 and had negative cash flow from operating activities in the amount of approximately $ 7,541. The Company's ability to continue as a going concern is dependent upon it raising additional capital and attaining positive cash flow.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The significant policies followed in the preparation of the consolidated financial statements are:

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reporting amounts of revenues and expenses during the reporting period notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The functional currency of the Company is the U.S. dollar, as the U.S. dollar is the currency of the primary economic environment in which the Company operates and expects to continue to operate in the foreseeable future. The majority of the Company's operations is currently conducted by the Israeli subsidiary and most of the Israeli expenses are currently paid in new Israeli shekels ("NIS"); however, these operations are denominated and determined in U.S. dollars. All of the Company's revenues are generated in U.S. dollars, its cash is invested almost entirely in U.S. dollar deposits and its other financing activities including loans and equity transactions are made in U.S. dollars.

The Company's transactions and balances denominated in U.S. dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured to U.S. dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52 of the U.S. Financial Accounting Standards Board ("FASB"). All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of Finjan Software Inc. and its wholly owned subsidiaries, Finjan Software Ltd., Finjan Inc., Finjan Software U.K. Limited and Finjan Software GmbH. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are considered to be highly liquid investments, which include unrestricted short-term bank deposits with original maturities of three months or less.

e. Long-term lease deposits:

Long-term lease deposits include long-term deposits for facilities and motor vehicles leasing, presented at their cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

f. Property and equipment:

Property and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

| | % |
|---|---|
| Computers and peripheral equipment | 33 |
| Office furniture and equipment | 6 - 20 |
| Leasehold improvements | Over the term of the lease |

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No.144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No.144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2004, no impairment losses have been identified.

g. Research and development costs:

SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon the completion of a working model. The Company does not incur material costs between the completion of the working model and the point at which the product is ready for general release. Therefore, research and development costs are charged to the statement of operations as incurred.

h. Concentrations of credit risk:

SFAS No. 105, "Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk", requires disclosure of any significant off-balance-sheet and credit risk concentrations. The Company has no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Cash and cash equivalents are invested in major banks in Israel and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers located in Europe and the U.S. The Company performs ongoing credit evaluations of their customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to specific amounts that the Company has determined to be doubtful of collection.

l. Revenue recognition:

The Company derives its revenue from sales of hardware appliance, software license fees and sub-license fees of its products, maintenance and support and rendering of consulting services including training and installation. The Company sells its products indirectly through distributors, resellers and directly to end-users, all of whom are considered end-users.

The Company recognizes software license revenue in accordance with Statement of Position SOP 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair value of the elements. When contracts contain multiple elements wherein vendor specific objective evidence (VSOE) of fair value exists for all undelivered elements, the Company accounts for the delivered elements in accordance with the "Residual Method" prescribed by SOP 98-9. Maintenance and support revenue included in these arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The VSOE of fair value of the undelivered elements (maintenance, support and services) is determined based on the price charged for the undelivered element when sold separately.

Revenue from software license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectability is probable.

When VSOE of fair value did not exist for all undelivered elements the Company recognized the product sale and maintenance revenue ratably over the maintenance period.

Deferred revenue includes amounts invoiced to or received from customers for which revenue has not been recognized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Service revenue is primarily comprised of revenue from standard maintenance agreements, consulting and training fees. The Company recognizes revenues from maintenance over the contractual period of the maintenance agreement, which is generally one year. Consulting services are billed at an agreed upon rate plus out-of-pocket expenses, and training services are billed on a per session basis. The Company recognizes service revenue from consulting and training when provided to the customer.

j. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") and Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44") in accounting for its employee stock option plans. Under APB 25, when the exercise price of the Company's stock options is less than the market price of the underlying stocks on the date of grant, compensation expense is recognized.

The Company applies SFAS No. 123, "Accounting for Stock-Based Compensation" and Emerging Issues Task Force ("EITF") 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or In Conjunction with Selling Goods or Services", with respect to warrants and options issued to non-employees and consultants. SFAS No. 123 requires the use of option valuation models to measure the fair value of the warrants at the grant date.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock Based Compensation Transition and Disclosure - an Amendment of FASB Statement No. 123" ("SFAS 148"). SFAS 148 permits two additional transition methods for entities that adopt the fair value based method of accounting for stock-based employee compensation. The Statement also requires new disclosures about the ramp-up effect of stock-based employee compensation on reported results. The Statement also requires that those effects be disclosed more prominently by specifying the form, content, and location of those disclosures. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. As of the balance sheet date, the Company continues to apply APB 25.

Pro forma information regarding the Company's net loss and net loss per stock is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123. However, the pro-forma information required by SFAS No 123 is not disclosed due to its immateriality.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Severance pay.

Finjan Ltd.'s liability for severance pay is calculated pursuant to Israeli's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. Finjan Ltd.'s liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expenses for the years ended December 31, 2004 and 2003, amounted to approximately $ 261 and $ 144, respectively.

l. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, and other accounts receivable, trade payables and current maturities of capital lease obligations approximate their fair value due to the short-term maturity of such instruments.

The carrying amount of the Company's long-term capital lease obligations approximates its fair value. The fair value was estimated using the cash flow analysis.

m. Impact of recently issued accounting standards:

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), "Share-Based Payment" ("Statement 123R"), which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("Statement 123"). Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values, while Statement 123(R) requires all share-based payments to employees to be recognized based on their fair values. Statement 123R also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new Standard will be effective for the Company in the first interim period beginning after January 1, 2006. The Company does not expect that the adoption of SFAS 123R will have a material effect on its financial position or results of operation.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

### NOTE 3:- PROPERTY AND EQUIPMENT

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Cost: | | |
| Computers and peripheral equipment | $ 1,326 | $ 959 |
| Office furniture and equipment | 195 | 151 |
| Leasehold improvements | 61 | 61 |
| | 1,582 | 1,171 |
| Accumulated depreciation | 960 | 733 |
| Depreciated cost | $ 622 | $ 438 |

Depreciation expenses for the years ended December 31, 2004 and 2003 were $ 227 and $ 122, respectively.

### NOTE 4:- OBLIGATION UNDER CAPITAL LEASING CONTRACTS

a. The Company leased computer equipment under capital leasing contracts. The loans were linked to the U.S. dollar and bear interest at the rate of 8.55% subject to the changes in the LIBOR interest rate every three months. As of December 31, 2004, the Company has no further commitments regarding the capital lease contract.

b. Future minimum payments under capital leases:

| | |
|---|---|
| 2005 | $ 13 |
| 2006 | 12 |
| 2007 | 11 |
| 2008 | 9 |
| | $ 45 |

### NOTE 5:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company rents its facilities under operating leases in Israel, the United Kingdom, Germany and the United States.

Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2004, are as follows:

| | |
|---|---|
| 2005 | $ 725 |
| 2006 | 307 |
| 2007 | 102 |
| | $ 1,134 |

Rent expenses for the years ended December 31, 2004 and 2003, were $ 405 and $ 313, respectively.

[redacted]

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 5:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b. During the years 2004 and 2003, the Company provided bank guarantees to its lessor of leased accommodation in the amounts of $ 114 and $ 112, respectively.

c. Legal claim:

During 2003, the Company received a letter from a third party, alleging to a potential infringement of one of that party's patents. The Company responded that it does not believe that its product infringes the abovementioned patent. No further action has been taken to date. The Company does not believe that this claim has any merit, and the Company will vigorously defend itself against the claim presented therein, if necessary. The Company does not believe that this legal claim will have any impact on its financial statements.

NOTE 6: - STOCK CAPITAL

In September 2002, the Company underwent a reorganization whereby a new Delaware corporation, Finjan Software, Inc. was established, and all Preferred stock and some of the Common stock of Finjan Ltd. were exchanged for Preferred and Common stock of Finjan Software Inc. (see Note 1).

a. Composition of stock capital of Finjan Software, Inc:

| | December 31, 2004 | | December 31, 2003 | |
|---|---|---|---|---|
| | Authorized | Issued and outstanding | Authorized | Issued and outstanding |
| | Number of shares | | | |
| Common stock (1) | 27,000,000 | 247,190 | 15,000,000 | 187,946 |
| Series A Preferred stock (2) | 226,226 | 226,226 | 226,226 | 226,226 |
| Series B Preferred stock (2) | 2,574,493 | 2,574,493 | 2,574,493 | 2,574,493 |
| Series C Preferred stock (2) | 7,627,477 | 7,627,477 | 7,627,477 | 7,627,477 |
| Series D Preferred stock (2) | 7,712,082 | 6,426,735 | - | - |
| | 45,140,278 | 17,102,121 | 25,428,196 | 10,616,142 |

(1) Common stock:

Common stock confers upon its holders, pari passu, the right to receive notice of, and to participate in, all general meetings of the Company, to vote in such meetings, to receive dividends, and to participate in the distribution of the surplus assets of the Company in the event of liquidation of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**U.S. dollars in thousands (except share and per share data)**

NOTE 6: - STOCK CAPITAL (Cont.)

(2) Preferred stock:

Series A, B, C and D Preferred stock confer upon their holders the same rights conferred by the Common stock. In addition, each share of Preferred Series A, C and D stock is convertible into Common stock on a one for one basis and each share of Preferred Series B stock is convertible into 1.23 shares of Common stock. Each share of Preferred Series A, B, C and D stock is converted into Common stock at the applicable conversion price at the option of the holder and automatically upon the earlier of (i) a qualified initial public offering ("IPO"), which yields not less than $ 25,000 in net proceeds to the Company, or (ii) with respect to each class, a written consent or agreement of holders of majority of the outstanding shares of such class.

Holders of shares of Series D Preferred stock are entitled to a dividend prior to the Series A, B and C Preferred Stock and the Common stock, when and if declared, at a rate of $ 0.1245 per share per annum. Holders of Series C Preferred stock are entitled to receive a dividend, prior to the Series A and B Preferred stock and the Common stock, when and if declared, at a rate of $ 0.091 per share per annum. Such dividends shall not be cumulative.

In the event of a liquidation or deemed liquidation of the Company, in which the value of the assets available for distribution among the stockholders is $ 80,000 or less, then the all assets available for distribution between the stockholders will be distributed in the following order: (i) Series D Preferred stock shall be entitled to receive, prior to any other Common or Preferred stock, an amount per share equal to $ 1.5560 (subject to adjustments) for each outstanding share of Preferred D stock; (ii) Series C Preferred stock shall be entitled to receive, prior to Series A and B Preferred Stock and Common stock, an amount per share equal to $ 1.1382 (subject to adjustments) for each outstanding share of Preferred C Stock; (iii) Series B Preferred stock shall be entitled to receive, prior to Preferred A stock and Common stock, an amount per share equal to $ 1.4014 for each outstanding share of Preferred B stock (subject to adjustments); (iv) Series A Preferred stock shall be entitled to receive, prior to Common stock, an amount per share equal to $ 37.6 for each outstanding share of Preferred A stock; (v) upon completion of phases (i) to (iv) all remaining assets will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis. In the event that the value of the assets available for distribution exceeds $ 80,000, then Series A, B, C and D Preferred stock shall not be entitled to receive the liquidation preference described above, rather amounts available for distribution will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**U.S. dollars in thousands (except share and per share data)**

NOTE 6: - STOCK CAPITAL (Cont.)

b. Stock Option Plans:

As part of the reorganization all options convertible into Common B stock in Finjan Ltd. under Finjan Ltd.'s 1996 Stock Option Plan ("the 1996 Plan") were converted into options to purchase Common stock of Finjan Software, Inc under the 2003 Plan (as defined below).

In December 2003, the Company's Board of Directors approved a new stock option plan ("the 2003 Plan"), and chose the Capital Gain Course, pursuant to the provisions of Section 102 of Israel's Income Tax Ordinance. Options granted under the 2003 Plan vest over a period of four years, and expire no later than 10 years from the date of grant. The Company reserved 4,796,689 shares of Common stock for issuance of options under the 2003 Plan. Pursuant to the 2003 Plan, the Company granted 2,777,159 options to employees of the Company.

A summary of the stock options activities in 2004 and 2003, is as follows:

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| | | $ | | $ |
| Outstanding at beginning of year | 2,435,791 | 0.17 | 12,616 | 8.2 |
| Granted | 720,000 | 0.14 | 2,467,642 | 0.14 |
| Exercised | (59,244) | 0.14 | - | - |
| Forfeited | (319,388) | 0.15 | (44,467) | 1.0 |
| Outstanding at end of year | 2,777,159 | 0.16 | 2,435,791 | 0.17 |

The options outstanding as of December 31, 2004, have been separated into ranges of exercise price as follows:

| Exercise price | Options outstanding as of December 31, 2004 | Weighted average remaining contractual life | Weighted average exercise price | Exercisable as of December 31, 2004 | Weighted average exercise price of options exercisable |
|---|---|---|---|---|---|
| $ | Amount | Years | $ | Amount | $ |
| 0.14 | 2,392,022 | 9.03 | 0.14 | 1,469,399 | 0.14 |
| 0.16 | 177,250 | 9.88 | 0.16 | - | 0.16 |
| 3.00 | 5,172 | 9.83 | 3.00 | 5,172 | 3.00 |
| 14.00 | 50 | 9.83 | 14.00 | 50 | 14.98 |
| 23.00 | 126 | 9.83 | 23.00 | 126 | 23.00 |
| 25.00 | 1,645 | 9.83 | 25.00 | 1,645 | 25.00 |
| | 2,777,159 | 9.14 | 0.16 | 1,476,386 | 0.18 |

U.S. dollars in thousands (except share and per share data)

## NOTE 6:- STOCK CAPITAL (Cont.)

Options to consultants:

| Issuance Date | In connection with | Number of options granted | Options exercisable | Exercise price per share | Exercisable through |
|---|---|---|---|---|---|
| 12/18/2003 | Consultants | 35,000 | 16,042 | 0.14 | 12/18/2013 |
| 10/25/2004 | Consultants | 3,000 | - | 0.16 | 10/25/2014 |
| 10/25/2004 | Consultants | 102 | 102 | 3 | 10/25/2014 |
| 10/25/2004 | Consultants | 100 | 100 | 25 | 10/25/2014 |
| | | 38,202 | 16,244 | 0.31 | |

c. Purchase offer:

On October 27, 2003, the Company offered to all stockholders of Finjan Ltd. other than the Company ("the Stockholders"), to purchase all of their holdings in Finjan Ltd. ("the shares"), approximately 107,965 shares at a price per share of $ 0.14. Stockholders holding more than the 90% of the shares (including one of the directors and officers of Finjan Software Ltd., who holds 105,595 shares), agreed to sell their shares to the Company at the offered price per share, as a result, the Company was able to enforce the sale on all other Stockholders. The transaction was completed during March 2004.

d. Treasury stock:

On December 30, 2003, the Company purchased 66,296 shares of its outstanding Common stock for a total consideration of $ 9. These shares were recorded as Treasury stock.

## NOTE 7:- TAXES ON INCOME

a. Measurement of results for tax purposes under the Israeli Income Tax Law (Inflationary Adjustments), 1985:

Results for tax purposes of Finjan Ltd. are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli CPI. As explained in Note 2b, the financial statements are presented in U.S. dollars. The difference between the annual change in the CPI and in the NIS/dollar exchange rate causes a difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the difference between the functional currency and the tax bases of assets and liabilities.



 

NOTE 7:- TAXES ON INCOME (Cont.)

After the balance sheet date, Finjan Ltd. Applied to the Israeli Income Tax Authorities in order to report its annual income filings for tax purposes in U.S. dollars. As a result, commencing fiscal year 2005, Finjan Ltd. Will report to the Israeli Income Tax Authorities in U.S. dollars.

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

On October 13, 1996, the production facilities of Finjan Ltd. were granted the status of an "Approved Enterprise" under the Law. On October 10, 2001, an expansion of the "Approved Enterprise" was granted to the Company.

According to the provisions of the Law, Finjan Ltd. has chosen to enjoy "Alternative Benefits" - waiver of grants in return for tax exemption - and accordingly, its income from the "Approved Enterprise" is tax-exempt for a period of two years, and subject for an additional period of five-eight years of reduced tax rates between 10% to 25%, depending upon the proportion of foreign ownership of Finjan Ltd. The period of benefits relating to these investment programs will expire in the years 2013 through 2016.

In the event of distribution of cash dividends from income that is tax exempt as mentioned above, Finjan Ltd. would have to pay income tax equal to 10% to 25% of the amount distributed. The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting Finjan Ltd. to taxes only upon the complete liquidation of Finjan Ltd.

Finjan Ltd. currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

The entitlement to the above benefits is conditional upon Finjan Ltd.'s fulfilling the conditions stipulated by the above law, regulations published their under and the instruments approved for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and Finjan Ltd. may be required to refund the amount of the benefits, in wholle or in part, including interest.

Should Finjan Ltd. derive income from sources other than the "Approved Enterprise" during the relevant period of benefits, such income will be taxable at the regular corporate tax rate of 35%, which will be reduced to 34% in January 2005, and will be further reduced to 32% in 2006 and 30% in 2007.

c. Tax assessments:

Finjan Ltd. has not received final tax assessments since its incorporation.

[redacted]



## NOTE 7:- TAXES ON INCOME (Cont.)

d. Net operating losses carryforwards:

As of December 31, 2004, Finjan Ltd. has accumulated losses for Israeli tax purposes of approximately $ 13,000, which may be carried forward and offset against taxable income for an indefinite period in the future. The Company expects that during the period these tax losses are utilized its income would be substantially tax-exempt. Accordingly, there will be no tax benefit available from such losses and no deferred income taxes have been included in these financial statements.

As of December 31, 2004, Finjan and Finjan Inc. have combined losses carried forward amounting to approximately $ 2,000

e. Deferred taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for income tax purposes.

The Company has provided valuation allowances in respect of deferred tax assets, since it has a history of losses. Management currently believes that it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized in the near future.

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# Exhibit 5

[redacted]

EXHIBIT
1034
TA 10-5-07

# FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

# CONSOLIDATED FINANCIAL STATEMENTS

# AS OF DECEMBER 31, 2006

ERNST & YOUNG

Joint Trial Exhibit
**JTX-28**
Case No. 06-369 GMS

Kost Forer Gabbay & Kasierer

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006

IN U.S. DOLLARS

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ERNST & YOUNG

Kost Forer Gabbay & Kasierer
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Tel-Aviv 67067, Israel

Phone: 972-3-6232525
Fax: 972-3-5622555

## REPORT OF INDEPENDENT AUDITORS

To the Stockholders of

## FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of Finjan Software, Inc. ("the Company") and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, in 2006 the Company adopted Financial Accounting Standard Board Statement No. 123(R), "Share-Based Payment".

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2006 and 2005, and the consolidated results of its operations and cash flows for each of the two years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel
June 3, 2007

Kost Forer Gabbay and Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

**U.S. dollars in thousands (except share and per share data)**

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 9,664 | $ 8,420 |
| Restricted cash | 116 | 106 |
| Trade receivables | 3,198 | 2,423 |
| Deferred costs | 1,538 | 937 |
| Prepaid expenses and other accounts receivable (Note 3) | 530 | 383 |
| Inventory | 424 | 420 |
| Total current assets | 15,470 | 12,689 |
| LONG-TERM PREPAID EXPENSES AND DEPOSITS: | | |
| Deferred costs | 1,399 | 511 |
| Prepaid expenses and deposits | 98 | 75 |
| Total long-term prepaid expenses and deposits | 1,497 | 586 |
| SEVERANCE PAY FUND | 545 | 384 |
| PROPERTY AND EQUIPMENT, NET (Note 4) | 744 | 486 |
| Total assets | $ 18,256 | $ 14,145 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $ 1,508 | $ 633 |
| Employees and payroll accruals | 925 | 875 |
| Deferred revenues | 7,677 | 5,340 |
| Accrued expenses and other liabilities | 1,508 | 974 |
| Total current liabilities | 11,618 | 7,822 |
| LONG-TERM LIABILITIES: | | |
| Long-term deferred revenues | 5,579 | 3,061 |
| Accrued severance pay | 745 | 535 |
| Total long-term liabilities | 6,324 | 3,596 |
| STOCKHOLDERS' EQUITY (Note 6): | | |
| Stock capital - | | |
| Common stock of $ 0.01 par value - Authorized: 36,000,000 and 27,000,000 shares at December 31, 2006 and 2005, respectively; Issued and outstanding: 365,237 and 347,065 shares at December 31, 2006 and 2005, respectively | 4 | 4 |
| Series A, B, C and D Preferred stock of $ 0.01 par value - Authorized: 25,842,726 and 19,104,289 shares at December 31, 2006 and 2005, respectively; Issued and outstanding: 25,842,726 and 19,104,289 shares at December 31, 2006 and 2005, respectively; Aggregate liquidation preference of $ 44,781 at December 31, 2006 | 258 | 191 |
| Additional paid-in capital | 52,749 | 42,331 |
| Treasury stock | (9) | (9) |
| Accumulated deficit | (52,688) | (39,790) |
| Total stockholders' equity | 314 | 2,727 |
| Total liabilities and stockholders' equity | $ 18,256 | $ 14,145 |

The accompanying notes are an integral part of the consolidated financial statements.

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands

| | Year ended December 31, 2006 | Year ended December 31, 2005 |
|---|---|---|
| Revenues | $ 8,396 | $ 6,877 |
| Patent license revenues | - | 8,000 |
| Total revenues | 8,396 | 14,877 |
| Cost of revenues (1) | 3,641 | 2,200 |
| Gross profit | 4,755 | 12,677 |
| Operating expenses: | | |
| Research and development (2) | 5,377 | 3,669 |
| Selling and marketing (3) | 10,397 | 7,133 |
| General and administrative (4) | 2,284 | 2,721 |
| Total operating expenses | 18,058 | 13,523 |
| Operating loss | (13,303) | (846) |
| Financial and other income, net | 459 | 129 |
| Loss before taxes on income | (12,844) | (717) |
| Taxes on income | 54 | 37 |
| Net loss | $ (12,898) | $ (754) |

(1) Includes equity-based compensation expense in the amount of $ 5 and $ 0 for the years ended December 31, 2006 and 2005, respectively.

(2) Includes equity-based compensation expense in the amount of $ 24 and $ 0 for the years ended December 31, 2006 and 2005, respectively.

(3) Includes equity-based compensation expense in the amount of $ 35 and $ 0 for the years ended December 31, 2006 and 2005, respectively.

(4) Includes equity-based compensation expense in the amount of $ 30 and $ 0 for the years ended December 31, 2006 and 2005, respectively.

The accompanying notes are an integral part of the consolidated financial statements.

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

U.S. dollars in thousands (except share data)

| | Common stock | | Preferred stock | | Additional paid-in capital | Treasury stock | Accumulated deficit | Total stockholders' equity |
|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | | | | |
| Balance as of January 1, 2005 | 247,190 | $ 3 | 16,854,931 | $ 168 | $ 38,904 | $ (9) | $ (39,036) | $ 30 |
| Conversion of convertible loan | - | - | 964,011 | 10 | 1,490 | - | - | 1,500 |
| Issuance of Series D Preferred stock, net | - | - | 1,285,347 | 13 | 1,920 | - | - | 1,933 |
| Options exercised | 99,875 | 1 | - | - | 17 | - | - | 18 |
| Net loss | - | - | - | - | - | - | (754) | (754) |
| Balance as of December 31, 2005 | 347,065 | 4 | 19,104,289 | 191 | 42,331 | (9) | (39,790) | 2,727 |
| Equity based compensation expenses resulting from FAS 123(R) | - | - | - | - | 94 | - | - | 94 |
| Issuance of Series D Preferred stock, net | - | - | 6,738,437 | 67 | 10,321 | - | - | 10,388 |
| Options exercised | 18,172 | - | - | - | 3 | - | - | 3 |
| Net loss | - | - | - | - | - | - | (12,898) | (12,898) |
| Balance as of December 31, 2006 | 365,237 | $ 4 | 25,842,726 | $ 258 | $ 52,749 | $ (9) | $ (52,688) | $ 314 |

The accompanying notes are an integral part of the consolidated financial statements.

FINJAN SOFTWARE, INC. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

**U.S. dollars in thousands**

| | Year ended December 31, 2006 | 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (12,898) | $ (754) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | 324 | 284 |
| Stock-based compensation expenses related to employees stock options | 94 | - |
| Decrease (increase) in trade receivables, net | (775) | 1,040 |
| Increase in deferred costs | (1,489) | (1,180) |
| Increase in prepaid expenses and other accounts receivable | (147) | (75) |
| Increase in inventory | (255) | (211) |
| Increase in trade payables | 875 | 40 |
| Increase (decrease) in employees and payroll accruals and accrued expenses and other liabilities | 584 | (283) |
| Increase in deferred revenues | 4,855 | 1,800 |
| Increase (decrease) in severance pay, net | 49 | (31) |
| Net cash provided by (used in) operating activities | (8,783) | 630 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (331) | (149) |
| Disposal of property and equipment | - | 1 |
| Decrease (increase) in long-term deposits and prepaid expenses | (23) | 94 |
| Net cash used in investing activities | (354) | (54) |
| Cash flows from financing activities: | | |
| Convertible loan received | - | 1,500 |
| Proceeds from issuance of shares, net | 10,388 | 1,933 |
| Options exercised | 3 | 18 |
| Net cash provided by financing activities | 10,391 | 3,451 |
| Increase in cash and cash equivalents | 1,254 | 4,027 |
| Cash and cash equivalents at the beginning of the year | 8,526 | 4,499 |
| Cash and cash equivalents at the end of the year | $ 9,780 | $ 8,526 |
| Supplemental disclosure of non-cash financing activities: | | |
| Conversion of convertible loan into Preferred stock | $ - | $ (1,500) |

The accompanying notes are an integral part of the consolidated financial statements.

NOTE 1:- GENERAL

a. Finjan Software, Inc. ("Finjan") and its subsidiaries (together "the Company" or "the Finjan Group") are engaged in the development, marketing and sale of proactive behavior-based security solutions for enterprises, small and medium-sized businesses. Finjan's security solutions are based on Finjan's patented Application-Level Behavior Blocking which provides protection against both known and unknown attacks, the first time they strike (e.g. Spyware, phishing, malicious code, viruses, worms and Trojans). Finjan's proactive behavior-based security solutions integrate anti-virus, and URL filtering.

Finjan, a Delaware corporation, was incorporated in June 2002 and commenced operations in September 2002. As a result of a reorganization that occurred in 2002, Finjan became the parent company of the following wholly-owned subsidiaries:

1. Finjan Software Ltd. ("Finjan Ltd." or "the Israeli subsidiary") was incorporated in Israel and commenced operations in January 1996. As a result of the reorganization, Finjan became the parent company of Finjan Ltd. owning 100% of its shares.

2. Finjan Inc. ("Finjan Inc.") was incorporated in the State of California as a wholly-owned subsidiary of Finjan Ltd. and commenced operations in January 1997. During 1998, Finjan Inc. was reincorporated in the State of Delaware. In October 2003, Finjan Ltd. transferred all of its shares in Finjan Inc. to Finjan. As a result of this transfer, Finjan Inc. became a wholly-owned subsidiary of Finjan.

3. Finjan Software (UK) Ltd. ("Finjan UK") was incorporated under the laws of the United Kingdom, as a wholly-owned subsidiary of Finjan Ltd. in March 2003. In October 2003, Finjan Ltd. transferred its share in Finjan UK to Finjan. As a result of this transfer, Finjan UK became a wholly-owned subsidiary of Finjan. Finjan UK is engaged in marketing the Company's products in the UK and Ireland.

4. Finjan Software GmbH ("Finjan GmbH") was incorporated in August 2004 under the laws of Germany as a wholly-owned subsidiary of Finjan. Finjan GmbH is engaged in marketing the Company's products in Germany, Austria and Switzerland.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The significant policies followed in the preparation of the consolidated financial statements are:

a. Use of estimates:

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reporting of amounts for revenues and expenses during the reported period. Actual results could differ from those estimates.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Financial statements in U.S. dollars:

The functional currency of the Company is the U.S. dollar, as the U.S. dollar is the currency of the primary economic environment in which the Company operates and expects to continue to operate in the foreseeable future. The majority of the Company's operations are currently conducted by the Israeli subsidiary and most of the Israeli expenses are currently paid in new Israeli shekels ("NIS"); however, these operations are denominated and determined in U.S. dollars. Most of the Company's revenues are generated in U.S. dollars, its cash is invested almost entirely in U.S. dollar deposits and its other financing activities including loans and equity transactions are made in U.S. dollars.

The Company's transactions and balances denominated in U.S. dollars are presented at their original amounts. Non-dollar transactions and balances have been remeasured to U.S. dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52 of the U.S. Financial Accounting Standards Board ("FASB"). All transaction gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

d. Reclassification

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

e. Cash and cash equivalents:

The Company and its subsidiaries consider all highly liquid investments, which are readily convertible to cash with a maturity of three months or less at the date of acquisition, to be cash equivalents.

f. Long-term lease deposits:

Long-term lease deposits include long-term deposits for the leasing of facilities and motor vehicles, presented at their cost.

g. Inventory:

Inventories are stated at the lower of cost or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company and its subsidiaries periodically evaluate the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation, provisions are recorded when required to write-off inventory according to its market value.

h. Property and equipment:

Property and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets at the following annual rates:

| | % |
|---|---|
| Computers and peripheral equipment | 33 |
| Office furniture and equipment | 6 - 20 |
| Leasehold improvements | Over the shorter of the related lease period or the life of the asset |

i. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets" ("SFAS No. 144"), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During 2005 and 2006, no impairment losses have been identified.

j. Research and development costs:

Research and development costs are charged to the statement of operations as incurred. Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"), requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a working model. No costs are incurred by the Company between the completion of the working model and the point at which the products are ready for general release. Therefore, research and development costs have been expensed.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Concentrations of credit risk:

SFAS No. 105, "Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk", requires disclosure of any significant off-balance-sheet and credit risk concentrations. The Company has no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables and other accounts receivable.

Cash and cash equivalents are invested in major banks in Israel, Germany, the United Kingdom and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The trade receivables of the Company are mainly derived from sales to customers located in Europe and the U.S. The Company performs ongoing credit evaluations of their customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to specific amounts that the Company has determined to be doubtful of collection.

l. Revenue recognition:

The Company derives its revenue from sales of hardware appliances, software license fees and sub-license fees of its products, training, maintenance and support. In 2005, the Company adopted a new business model, according to which the Company provides its product for a limited subscription period. The Company sells its products indirectly through distributors and resellers, and directly to end-users.

Product revenues on shipment to distributors are deferred until the distributors resell the Company's products to the end-users ("sell through").

Revenues are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectability is probable.

The Company recognizes its revenues in accordance with Statement of Position SOP 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. SOP 97-2 generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair value of the elements. When contracts contain multiple elements wherein Vendor Specific Objective Evidence (VSOE) of fair value exists for all undelivered elements, the Company accounts for the delivered elements in accordance with

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

the "Residual Method" prescribed by SOP 98-9. Maintenance and support revenue included in these arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The VSOE of fair value of the undelivered elements (maintenance, support and services) is determined based on the price charged for the undelivered element when sold separately.

According to Emerging Issues Task Force 03-5, "Application of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software" ("EITF 03-5") in an arrangement that includes software that is more than incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. The Company's products consist of appliances upon which the Company's software is installed. The software and hardware appliances are a bundled solution and are mutually essential to each other's functionality; therefore, related revenues are recognized together throughout the subscription period of each agreement.

Deferred revenue includes amounts invoiced to customers for which revenue has not yet been recognized. Related direct costs of these deferred revenues are being deferred as well, and recognized throughout the subscription period.

m. Accounting for stock-based compensation:

Prior to January 1, 2006, the Company accounted for its stock based compensation awards using the intrinsic value method, under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related Interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation".

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), "Share-Based Payment" ("SFAS 123(R)"), using the prospective-transition method. SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statement of Operations.

Under the prospective-transition method, compensation costs recognized in 2006 includes compensation costs for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R).

Total stock-based compensation expense resulting from stock options included in the consolidated statement of operations for the year ended December 31, 2006 was $ 94. This amount was allocated to each line item in the consolidated statement of operations as required by Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107").

Pro forma information is not disclosed for the year ended December 31, 2005 as required by SFAS 123 due to its immateriality.

As of December 31, 2006, the total unrecognized estimated compensation cost related to non-vested stock options granted prior to that date was $ 198, which is expected to be recognized over a period of up to four years.

n. Severance pay:

Finjan Ltd.'s liability for severance pay is calculated pursuant to Israel's Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. Finjan Ltd.'s liability for all of its employees is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense for the years ended December 31, 2006 and 2005, amounted to approximately $ 291 and $ 228, respectively.

o. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating their fair value and disclosures for financial instruments:

The carrying amount reported in the balance sheet for cash and cash equivalents, trade receivables and trade payables approximate their fair value due to the short-term maturities of such instruments.

p. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes", ("SFAS No. 109"). This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value, if it is more likely than not that some portion of the entire deferred tax asset.

U.S. dollars in thousands (except share and per share data)

## NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Impact of recently issued accounting standards:

In July 2006, the Financial Accounting Standards Board ("FASB") issued Financial Interpretation No. 48, "Accounting for Uncertainly in Income Taxes" ("FIN 48"), which applies to all tax positions related to income taxes subject to Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes". FIN 48 requires a new evaluation process for all tax positions taken. If the probability for sustaining said tax position is greater than 50%, then the tax position is recorded and recognition should be at the highest amount that is greater than 50% likely of being realized upon ultimate settlement. FIN 48 requires expanded disclosure at each annual reporting period, unless a significant change occurs in an interim period. Differences between the amount recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as an adjustment to the beginning balance of retained earnings. FIN 48 is effective for fiscal years beginning after December 15, 2006.

The Company is currently evaluating the impact of the adoption of FIN 48 and has not yet determined what impact, if any, it will have on the Company's financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurement" ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not anticipate any material impact on its consolidated financial statements upon the adoption of SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 159 on its consolidated financial position and results of operations.

## NOTE 3:- PREPAID EXPENSES AND OTHER ACCOUNTS RECEIVABLE

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Prepaid expenses | $ 407 | $ 339 |
| Lease deposits | 42 | 25 |
| Other | 81 | 19 |
| | $ 530 | $ 383 |

U.S. dollars in thousands (except share and per share data)

## NOTE 4:- PROPERTY AND EQUIPMENT

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Cost: | | |
| Computers and peripheral equipment | $ 1,976 | $ 1,443 |
| Office furniture and equipment | 172 | 165 |
| Leasehold improvements | 91 | 67 |
| | 2,239 | 1,675 |
| Accumulated depreciation | 1,495 | 1,189 |
| Depreciated cost | $ 744 | $ 486 |

Depreciation expenses for the years ended December 31, 2006 and 2005 were $ 324 and $ 284, respectively.

## NOTE 5:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company rents its facilities under operating leases in Israel, the United Kingdom, Germany and the United States. In addition, the company rents certain motor vehicles under operating lease agreements.

Aggregate minimum rental and lease commitments under non-cancelable leases as of December 31, 2006, are as follows:

| | |
|---|---|
| 2007 | $ 1,488 |
| 2008 | 830 |
| 2009 | 220 |
| | $ 2,538 |

Rent and motor vehicle lease expenses for the years ended December 31, 2006 and 2005, were $ 1,199 and $ 1,075, respectively.

b. During the years 2006 and 2005, the Company provided bank guarantees to the lessor of its premises in the amounts of $ 116 and $ 106, respectively.

U.S. dollars in thousands (except share and per share data)

## NOTE 6: - STOCK CAPITAL

a. Composition of stock capital of Finjan Software, Inc:

| | December 31, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| | Authorized | Issued and outstanding | Authorized | Issued and outstanding |
| | Number of shares | | | |
| Common stock (1) | 36,000,000 | 365,237 | 27,000,000 | 347,065 |
| Series A Preferred stock (2) | 226,226 | 226,226 | 226,226 | 226,226 |
| Series B Preferred stock (2) | 2,574,493 | 2,574,493 | 2,574,493 | 2,574,493 |
| Series C Preferred stock (2) | 7,627,477 | 7,627,477 | 7,627,477 | 7,627,477 |
| Series D Preferred stock (2) | 15,414,530 | 15,414,530 | 8,676,093 | 8,676,093 |
| | 61,842,726 | 26,207,963 | 46,104,289 | 19,451,354 |

(1) Common stock:

Currently, 36,000,000 shares of Common stock are authorized. Holders of the Common stock are entitled to one vote per share on all matters to be voted upon by the Company's shareholders. Subject to the rights of the holders of the Preferred stock, if any, in the event of liquidation, holders of the Common stock are entitled to share ratably in all of the Company's assets.

(2) Preferred stock:

Series A, B, C and D Preferred stock confer upon their holders the same rights conferred by the Common stock. In addition, each share of Preferred A, C and D stock is convertible into Common stock on a one for one basis and each share of Preferred B stock is convertible into 1.23 shares of Common stock. Each share of Preferred A, B, C and D stock is convertible into Common stock at the applicable conversion price at the option of the holder and automatically upon the earlier of (i) a qualified initial public offering ("IPO"), which yields not less than $ 25,000 in net proceeds to the Company, or (ii) with respect to each class, a written consent or agreement of holders of majority of the outstanding shares of such class.

Holders of shares of Series D Preferred stock are entitled to a dividend prior to the Series A, B and C Preferred stock and the Common stock, when and if declared, at a rate of $ 0.1245 per share per annum. Holders of Series C Preferred stock are entitled to receive a dividend, prior to the Series A and B Preferred stock and the Common stock, when and if declared, at a rate of $ 0.091 per share per annum. Such dividends shall not be cumulative.

NOTE 6: - STOCK CAPITAL (Cont.)

In the event of a liquidation or deemed liquidation of the Company, in which the value of the assets available for distribution among the stockholders is $ 80,000 or less, then all assets available for distribution between the stockholders will be distributed in the following order: (i) Series D Preferred stock shall be entitled to receive, prior to any other Common or Preferred stock, an amount per share equal to $ 1.5560 (subject to adjustments) for each outstanding share of Preferred D stock; (ii) Series C Preferred stock shall be entitled to receive, prior to Series A and B Preferred stock and Common stock, an amount per share equal to $ 1.1382 (subject to adjustments) for each outstanding share of Preferred C stock; (iii) Series B Preferred stock shall be entitled to receive, prior to Preferred A stock and Common stock, an amount per share equal to $ 1.4014 for each outstanding share of Preferred B stock (subject to adjustments); (iv) Series A Preferred stock shall be entitled to receive, prior to Common stock, an amount per share equal to $ 37.6 for each outstanding share of Preferred A stock; (v) upon completion of phases (i) to (iv) all remaining assets will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis. In the event that the value of the assets available for distribution exceeds $ 80,000, then Series A, B, C and D Preferred stock shall not be entitled to receive the liquidation preference described above, rather amounts available for distribution will be distributed ratably among the holders of Preferred and Common stock based on the number of shares of Common stock on an as converted basis.

(3) On June 21, 2005, the Company signed a convertible loan agreement ("the Loan") with certain stockholders, according to which the stockholders agreed to lend the Company an aggregate amount of $ 1,500 ("the principal amount"). The principal amount of the Loan bore interest at an annual rate of 8% paid upon the earlier of repayment or conversion of the Loan.

On June 30, 2005, the Company entered into a Stock Purchase Agreement ("the 2005 SPA") whereby it issued to a new investor 1,285,347 shares of Series D Preferred stock of $ 0.01 par value each in an aggregate amount of $ 2,000. As part of the SPA, the principal amount under the Loan was converted into 964,011 shares of Series D Preferred stock, at the same terms and conditions as provided to the new investor under the 2005 SPA.

On June 30, 2005, Finjan Ltd. entered into a patent license agreement ("the license agreement") with the new investor, according to which, simultaneously with the closing of the 2005 SPA, Finjan Ltd. on behalf of itself and its affiliates, shall provide the new investor and its affiliates, effective as of the payment date, a certain limited, worldwide, nonexclusive, nontransferable, royalty-free license to Finjan Ltd.'s patents, pursuant to the terms and conditions of the license agreement in consideration of $ 8,000.

b. In February 2006, the Company completed a stock purchase agreement ("the 2006 SPA"), whereby it issued to new and existing investors 6,426,735 shares of Series D Preferred stock of $ 0.01 par value each, in an aggregate amount of $ 10,000.

U.S. dollars in thousands (except share and per share data)

NOTE 6: - STOCK CAPITAL (Cont.)

c. In August 2006, the Company issued to a new investor an additional 311,702 shares of Series D Preferred stock of $ 0.01 par value each, for the aggregate amount of $ 485.

d. Stock Option Plans:

As part of the reorganization that occurred in 2002, all options convertible into Common B stock in Finjan Ltd. under Finjan Ltd.'s 1996 Stock Option Plan ("the 1996 Plan") were converted into options to purchase Common stock of Finjan Software, Inc under the 2003 Plan (as defined below).

In December 2003, the Company's Board of Directors approved a new stock option plan ("the 2003 Plan"), and chose the capital gain course, pursuant to the provisions of section 102 of Israel's Income Tax Ordinance. Options granted under the 2003 Plan vest over a period of four years, and expire no later than 10 years from the date of grant. As of December 31, 2006, the Company reserved 6,553,642 shares of Common stock for the exercise of options under the 2003 Plan. Pursuant to the 2003 Plan, the Company granted 4,963,993 options to employees of the Company and there are 1,589,649 options to purchase shares available for future grants.

e. Stock Option Plans:

The fair value of each option award is estimated on the date of grant using the Binomial model with the following weighted-average assumptions (annualized percentages):

Expected volatility is based on companies in a comparable stage, as well as companies in the industry. The expected term of options granted is based on the "Simplified" method acceptable by SAB 107. The risk-free rate is based on observed interest rates appropriate for the term of the Company's employee stock options. The dividend yield assumption is based on the Company's historical and expectation of future dividend payouts and may be subject to substantial change in the future.

| | Year ended December 31, 2006 |
|---|---|
| Volatility | 82.5% |
| Risk-free interest rate | 4.72% |
| Dividend yield | 0% |
| Expected life (years) | 6.015 |
| Suboptimal exercise factor | 1.75 |
| Pre-vest cancellation rate | 15% |
| Post-vest cancellation rate | 15% |

The average estimated fair value of employee stock options granted during the year ended December 31, 2006 was $ 0.23 per share.

U.S. dollars in thousands (except share and per share data)

NOTE 6: - STOCK CAPITAL (Cont.)

A summary of the Company's share options activity under the Plans is as follows:

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at beginning of year | 3,908,495 | $ 0.16 | 2,777,159 | $ 0.16 |
| Granted | 1,279,463 | $ 0.5 | 1,963,484 | $ 0.16 |
| Exercised | (18,172) | $ 0.15 | (99,875) | $ 0.14 |
| Forfeited | (205,793) | $ 0.2 | (732,273) | $ 0.18 |
| Outstanding at end of year | 4,963,993 | $ 0.25 | 3,908,495 | $ 0.16 |
| Exercisable options | 2,728,726 | $ 0.16 | 1,736,208 | $ 0.16 |

The options outstanding as of December 31, 2006, have been separated into ranges of exercise price as follows:

| Exercise price | Options outstanding as of December 31, 2006 | Weighted average remaining contractual life (years) | Weighted average exercise price | Options exercisable as of December 31, 2006 | Weighted average exercise price of options exercisable |
|---|---|---|---|---|---|
| $ 0.14 | 1,755,548 | 7.02 | $ 0.14 | 1,700,068 | $ 0.14 |
| $ 0.16 | 2,085,750 | 8.91 | $ 0.16 | 1,016,685 | $ 0.16 |
| $ 0.54 | 1,120,463 | 9.5 | $ 0.54 | 9,741 | $ 0.54 |
| $ 3 | 837 | 7.83 | $ 3 | 837 | $ 3 |
| $ 14 | 50 | 7.83 | $ 14 | 50 | $ 14 |
| $ 23 | 80 | 7.83 | $ 23 | 80 | $ 23 |
| $ 25 | 1,265 | 7.83 | $ 25 | 1,265 | $ 25 |
| | 4,963,993 | 8.37 | $ 0.25 | 2,728,726 | $ 0.16 |

As of December 31, 2006, there was $ 198 of total unrecognized compensation cost related to non vested share-based compensation arrangements granted pursuant to the Plan during 2006 under FAS 123R. That cost is expected to be recognized over a weighted-average period of 4 years.

f. Treasury stock:

On December 30, 2003, the Company purchased 66,296 shares of its outstanding Common stock for a total consideration of $ 9. These shares were recorded as Treasury stock.

U.S. dollars in thousands (except share and per share data)

## NOTE 7:- TAXES ON INCOME

a. Pre-tax loss is comprised of the following:

| | Year ended December 31, 2006 | Year ended December 31, 2005 |
|---|---|---|
| Domestic | $ (1,806) | $ (398) |
| Foreign | (11,035) | (319) |
| | $ (12,841) | $ (717) |

b. Measurement of results for tax purposes under the Israeli Income Tax (Inflationary Adjustments) Law, 1985:

Results of the Company's subsidiary for tax purposes are measured and reflected in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are measured in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company's subsidiary has not provided deferred income taxes on the difference between the reporting currency and the tax bases of assets and liabilities.

c. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

On October 13, 1996, the production facilities of Finjan Ltd. were granted status as an "Approved Enterprise" under the Law. On October 10, 2001, an expansion of the "Approved Enterprise" was granted to the Company.

According to the provisions of the Law, the Company has chosen to enjoy the "Alternative Benefits" track and, accordingly, its income from the "Approved Enterprise" is tax-exempt for a period of two years, commencing in the first year the Company has taxable income, and subject to an additional period of five to eight years of reduced tax rates between 10% to 25%, depending upon the proportion of foreign ownership in the Company in each tax year. The period of tax benefits is subject to limits of the earlier of 12 years from the commencement of production, or 14 years, from the approval date. Given the aforementioned conditions, the period of benefits relating to these investment programs will expire in the year 2015.

In the event of a distribution of cash dividends from tax exempt income as mentioned above, Finjan Ltd. would have to pay income tax equal to 10% to 25% of the amount distributed. The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting Finjan Ltd. to taxes only upon the complete liquidation of Finjan Ltd.

Finjan Ltd. currently has no plans to distribute dividends and intends to retain future earnings to finance the development of its business.

NOTE 7:- TAXES ON INCOME (Cont.)

The entitlement to the above benefits is conditional upon Finjan Ltd.'s fulfilling the conditions stipulated by the above law, regulations published thereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and Finjan Ltd. may be required to refund the amount of the benefits, in whole or in part, including interest. Management believes that Finjan Ltd. has complied with all relevant conditions.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as an "Approved Enterprise", such as provisions generally requiring that at least 25% of the "Approved Enterprise" income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Investment Law provides that terms and benefits included in any letter of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore the Israeli subsidiary's existing "Approved Enterprise" will generally not be subject to the provisions of the Amendment.

d. Reduction in Israeli tax rates:

In June 2004 and in July 2005, the "Knesset" (Israeli parliament) passed amendments to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 and (No. 147), 2005 respectively, which determine, among other things, that the corporate tax rate is to be gradually reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

e. Net operating losses carryforward:

As of December 31, 2006, the Company had a net U.S. operating loss carryforward for income tax purposes of approximately $ 19,120. The net operating loss carryforward expires within 18 years.

Utilization of the U.S. net operating losses above may be subject to substantial annual limitations due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of substantial net operating losses before utilization.

The Israeli subsidiary has a net operating loss carryforward for income tax purposes, as of December 31, 2006, of approximately $ 22,600 which can be carried forward and offset against taxable income indefinitely.

U.S. dollars in thousands (except share and per share data)

## NOTE 7:- TAXES ON INCOME (Cont.)

f. Deferred taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Loss carryforwards | $ 12,437 | $ 10,279 |
| Reserves and allowances | 1,650 | 1,162 |
| Total deferred tax asset before valuation allowance | 14,087 | 11,441 |
| Valuation allowance | (14,087) | (11,441) |
| Net deferred tax assets | $ - | $ - |

As of December 31, 2006, the Company has provided valuation allowances of $ 14,087, in respect of deferred tax assets resulting from tax loss carryforwards and other temporary differences. Management currently believes that it is more likely than not that the deferred tax in respect to the loss carryforward and other temporary differences will not be realized in the foreseeable future.

## NOTE 8:- SUBSEQUENT EVENTS (UNAUDITED)

a. On May 31, 2007, the Israeli subsidiary entered into a credit agreement. Under the terms of this agreement, the lenders extended to the Company a revolving credit line in the aggregate amount of $ 12,000. The Company may draw from time to time amounts up to this aggregate amount in dollars or in Euros, per the Company's request.

The credit installments shall bear interest as follows: (i) in the event that such installment was provided in dollars - 11.75% per annum, and (ii) in the event that the installment was provided in Euros - 10.75% per annum.

As part of the agreement, the Israeli subsidiary granted the lenders first priority floating and fixed charges over some of its assets, excluding the intellectual property

Additionally, as part of the agreement, the Company granted its lenders a warrant to purchase 700,000 shares of the Company's D Preferred stock, $ 0.01 par value each, at an exercise price equal to $ 2.1006 per share.

The warrants can be exercised for cash or by a cashless method, as specified in the agreement.

**NOTE 8:- SUBSEQUENT EVENTS (UNAUDITED) (Cont.)**

b. On June 5, 2006, the Company filed a patent infringement lawsuit against one of its competitors.

On May 4, 2007, the competitor filed a counterclaim against the Company for patent infringement.

The Company does not believe that this claim has any merit. The Company also does not believe that this legal claim will have any impact on its financial statements.

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# Exhibit 6

**THIS EXHIBIT HAS BEEN REDACTED IN ITS ENTIRETY**